Evidentiary Exhibit 51

Richmond Times Dispatch (Virginia)

August 12, 2001 Sunday City Edition

SECTION: DISCOVER RICHMOND; Pg. 68

LENGTH: 776 words

HEADLINE: GET HOUSING OVERVIEW *ONLINE*, THEN START SEARCHING

BYLINE: Donna Rogers, Contact Donna W. Rogers at (804) 649-6809 or drogers@timesdispatch.com,

BODY:

You've got a new job in Richmond, Virginia. You have to find a place to live. What do you do?

This was my situation more than a year ago. I was looking for an apartment. Others might be looking for a house in a landscaped neighborhood. These days, you can start in the same place: the *Internet*. (See agencies, Web sites, Page 72.)

Even if you want to move from one end of Richmond to another (East and West ends), change sides (North and South sides) or look in the surrounding counties, the *Internet* can help.

Don't forget real estate ads in the Richmond Times-Dispatch listings, which are also *online*.

What would you see in the market as you search for a new home?

Perusing the Web sites of groups such as the Richmond Association of Realtors and the Home Builders Association of Richmond shows buyers a good overview of the home market. Many planned communities with new homes for sale have model homes to tour and open house events that give buyers a chance to see home features and neighborhood amenities. Real estate agents also can help guide buyers to homes in their price ranges and locate communities that match their needs and desires. The Richmond Times-Dispatch's monthly Metro Real Estate section can help, too.

However, the single-family home market in greater Richmond appears to lack a sufficient amount of affordable housing. Real estate professionals, nonprofit housing groups and others see a real need for it. Some efforts are being made, such as in the Randolph and Blackwell sections of Richmond, to build affordable housing.

While there is no one catchy definition of affordable housing, for single-family homes most seem to think of it as those that list below $100,000. In May, during peak home-buying season, the average sales price of a single-family home in greater Richmond was $158,607, according to the Richmond Association of Realtors.

Richmond and Henrico County appear to have the most affordable single-family homes - as well as multifamily homes - compared to other cities and counties in central Virginia, experts have said. That could be because the available homes generally are older. Henrico was a prime destination for people leaving the city in the mid-1970s, so development has peaked.

But there are pockets of high-end homes in Richmond. Homes have been known to sell for hundreds of thousands of dollars in the Fan District - which has a large number of historic homes - and for millions of dollars in Windsor Farms, west on Cary Street from that area.

Hanover and Chesterfield counties, once very rural, are seeing the growth in housing that Henrico saw decades earlier and are trying to control it through zoning laws. Officials of those counties and others in central

Virginia are collecting fees with new home construction and mandating that many housing lots be spread out. That means fewer people can live in an area, which tends to make housing more expensive because builders charge more for the larger lots and to profit from fewer people.

The apartment stock also is lacking a sufficient number of affordable units. While old buildings and houses in Richmond have been renovated into apartments, rents have risen to $1,000 or more per month for many of them. Some affordable units - such as two-bedroom units that rent for $315 - are being torn down to make way for more expensive ones.

Many students live in the Fan District, which is near Virginia Commonwealth University. That area has much rental housing provided by individual investors and small businesses rather than large apartment companies. Often, several students lease space in houses, so rents vary according to the size of the homes, the number of renters, the size of the space rented in the homes and other factors. Rents have been advertised from a two-bedroom for $375 a month to a three-to-four-bedroom unit for $1,550 a month.

According to the February 2001 Richmond Apartment Market Report, which surveyed apartment complexes, greater Richmond had a multifamily market vacancy rate of 5.4 percent as of January, which means complexes were 94.6 percent occupied overall. The report covered 43,955 units, with 859 units under construction and 1,633 more proposed.

The average quoted rental rate in January was $637, with rents increasing $11.78 since July 2000. One-bedroom units averaged $604; two-bedroom, $629; and three-bedroom, $798.

The report was compiled by Carolinas Real Data with the cooperation of the Richmond Apartment Association.

Now that you have a view of the housing market, go find your favorite picture: the one with your home in it.

LOAD-DATE: August 15, 2001

Evidentiary Exhibit 52

Knight Ridder/Tribune News Service

The Philadelphia Inquirer

August 11, 2001, Saturday

SECTION: BUSINESS AND FINANCIAL NEWS

KR-ACC-NO: K4177

LENGTH: 446 words

HEADLINE: Homestore.com to absorb IPlace

BYLINE: By Linda Loyd

BODY:

PHILADELPHIA _ Two *Internet* companies announced Friday they are teaming up to provide homebuyers with not only the largest number of home-sale listings *online*, but also a streamlined way to research neighborhood information about crime, schools and quality of life.

In addition, consumers will be able to check their credit reports on the *Internet*.

Homestore.com Inc., which operates Realtor.com, the largest *online* Web site of homes for sale, announced it was buying iPlace Inc., of Langhorne, Pa., for $150 million.

Homestore.com will pay about $70 million in cash and $80 million in stock to iPlace shareholders and investors, said Stu Siegel, iPlace chief executive.

"The intent is to run the business and grow it as rapidly as possible with the resources that Homestore can provide us," Siegel said.

iPlace employs more than 200 people, including 60 in Bucks County, Pa., 120 in Orange, Calif., and a sales staff of 30 around the country.

Siegel said iPlace would operate as a division of Homestore.com, based in Westlake Village, Calif.

Siegel said iPlace did not expect to lose any jobs. "Although we can't assure no changes in employment," he said, "we are looking at probably increases in employment in this area."

The two companies aim to create one-stop shopping for real estate brokers and consumers.

Siegel said iPlace compiled and sold *online* demographic information about crime rates, schools, cost of living and home-sale values in cities and neighborhoods across the country.

In addition, iPlace.com offers free *online* credit checks and a $79.95-a-year credit-monitoring service. The company said 600,000 subscribers pay the annual fee. The monitoring service notifies consumers of changes in their credit status, including unfavorable information. The service also can detect fraud and identity theft.

Homestore.com in February bought Move.com, a unit of Cendant Corp., for $900 million in stock, joining the top two residential home-sale listing Web sites.

The purchase of iPlace, expected to close in the third quarter, would put Homestore.com among the 20 most visited sites on the *Internet*, the companies said.

More than 9.1 million people visited Homestore.com's site in July, while 6.7 million visited iPlace's site, according to Nielsen/Net ratings.

"About 300,000 Realtors subscribe to Homestore.com," Siegel said. "We can give those real estate professionals information about any neighborhood in the country. We are looking to distribute our product to their customer base."

Visit Philadelphia *Online*, the Inquirer's World Wide Web site, at http://www.philly.com/

JOURNAL-CODE: PH
LOAD-DATE: August 11, 2001

Evidentiary Exhibit 53

Newsday (New York)

July 13, 2001 Friday NASSAU AND SUFFOLK EDITION

SECTION: REAL ESTATE, Pg. C06

LENGTH: 2806 words

HEADLINE: The State Of Real E-state

BYLINE: By Cara S; Trager; Cara S; Trager is a freelance writer; She may be reached by e-mail at ecrivmere@aol;com

BODY:

When the dot-com craze became a crash last year, real estate Web sites were affected along with most e-commerce industries. Still, *Internet* usage by home buyers and sellers has skyrocketed. In the last four years, the Web, once perceived as a threat by many agents, has become an inextricable part of the business. Here is a special annual report on the evolving state of real e-state.

Marcella Connolly spent three months shopping for a house on Long Island - but she only left her Brooklyn apartment twice to do so.

For about three hours every weekend, Connolly, a manager at ABC Carpet & Home in Manhattan and the mother of three daughters, surfed the Web to learn about the Island's school districts, real estate prices and housing inventory. She eventually narrowed her *online* travels to four communities: Greenvale, Centerport, Northport and Huntington.

Through the *Internet*, she also found a mortgage site that helped determine how much she and her husband, Brian, who sells computer software, could afford to spend on a home: up to $450,000.

Finally, in February, she e-mailed Anne Marian, a broker at Daniel Gale Real Estate in Huntington, about homes she had listed on the Web. In response, Marian began e-mailing Connolly lists of more houses that might appeal to her.

Within a few days of contacting Marian, the couple trekked out to Long Island. Over a two-day period they saw 10 houses, including one she had seen on the Web that they eventually purchased: a $430,000, four-bedroom, three-bath house in Northport.

"The Web is a great source of information that also saves a lot of house-hunting trips," Connolly said. "Since we lived far away from where we wanted to purchase, I figured it would probably take us until the summer to find something, and then we'd move in by Christmas. But we found our home in February and moved in by May."

These days, Connolly's Web-based, home-buying strategy is increasingly the norm, rather than the exception. More than 60 percent of today's buyers use the *Internet* as a search tool, compared to only 2 percent six years ago, according to the National Association of Realtors, a Washington-based trade group.

By 2005, 80 percent of homebuyers and renters will employ the *Internet* as a research tool, estimates Jupiter Media Matrix, an *Internet* research firm in Manhattan.

The growing popularity of the *Internet* among buyers and renters has much to do with its convenience, as well as its breadth of information. Once a first step toward buying a home meant getting into the car, cranky children in tow, to check out neighborhoods and to see what amenities they offered, such as proximity to

shopping, main roads, schools and houses of worships. Today all that information and much more is available on the Web 24 hours a day.

Via the Web, consumers are not only researching neighborhoods and school rankings, but they also are educating themselves about what houses are selling for and where - information once the exclusive domain of brokers. And when buyers find a listing that appeals to them, they don't always have to make an appointment with a broker to see the property. Increasingly, they can take a "virtual tour" of the home's interior and exterior and decide whether it's worth their time and effort to make an off-line visit.

"There's less disappointment than with written ads," said Ellen Dioguardi, director of marketing at Cook Pony Farm Real Estate Inc. in East Hampton.

As a result, shoppers who use the *Internet* to view and evaluate homes generally look at about 12 homes in person before making their purchase. That compares to non-Web users, who look at an average of 21 homes, said Kathleen Sindell, author of "The Unofficial Guide to Buying a Home *Online*."

"The Web is rapidly becoming the preferred way," said Robert Sterling, senior analyst with Jupiter Media Matrix.

From June 2000 to April 2001, traffic to real estate sites grew 88.7 percent, outpacing traffic to the entire *Internet*, which grew 13.9 percent, according to Jupiter Media Matrix. Overall, 13 million people, or 15.3 percent of everyone *online*, visited at least one real estate site in May, as compared to 11.5 percent, or 9 million people, a year earlier.

Locally, the Web site of the Multiple Listing Service of Long Island/Long Island Board of Realtors, www.mlslirealtor.com, which covers Long Island and Queens, has also grown dramatically. "Since we began tracking the site over the past 18 months, we've seen it grow to 10,000 daily sessions," said Tricia Chirco, marketing and communications manager for the Realtors Board and MLS. Most visitors to the site make three or four searches, Chirco added.

"The Web will grow as a marketplace for buying and selling residential properties," Sindell said. Currently, the Net lists about 1.3 million homes for sale nationwide and includes more than 30,000 real estate-related Web sites, she said.

Still, the Web is not without its drawbacks.

For prospective buyers whose computers use a dial-up *Internet* service, rather than rely on a much speedier cable or DSL connection, browsing real estate sites can be frustrating. The amount of time it takes to download photos can easily tax the prospective buyer's patience. In addition, many Web sites aren't updated often enough, especially in active housing markets.

"By the time a house is on the *Internet*, it's gone or sold, especially if it's a solid, good value," said Mike Riccio, a broker with Prudential Long Island Realty in East Meadow.

Besides providing information about homes for sale and apartments for rent, many sites also feature links to ancillary real estate services, including homebuilders, home inspectors, insurance agents, architects, interior designers, movers and mortgage lenders. In many instances, real estate sites include tips on building, buying, selling, renting and renovating a home as well as information about moving and mortgages.

While the dot.com shake-out has resulted in many real estate sites shutting down or consolidating with larger operations, such as move.com merging with Homestore.com, the situation today is "not one of buyer beware," said Nick Karris, senior real estate analyst at Gomez Advisors Inc., a Waltham, Mass.-based *Internet*

research firm. "The companies that are still operating are the ones that have done the best job, and there's still a wealth of information out there."

Although he used the Web to nab a buyer for his own home, Dennis Cronk, immediate past president of the National Association of Realtors, said the *Internet* can "make the buying process difficult. It's information overload."

Even so, the information the *Internet* does give is far from the whole story.

For instance, a real estate site may have plenty of data about neighborhood school rankings, but there's little, if anything, on an area's morning and late-afternoon traffic patterns. And while virtual tours spotlight spacious rooms, few, if any, will zoom in on leaky pipes.

So while there are occasional stories about buyers who purchased a house without ever stepping into it, most people use the Web as a home-buying research tool - an initial time-saver, not the actual means of purchasing what is likely to be the most expensive asset they own.

In fact, in a 1999 National Association of Realtors survey of homebuyers who used the Web, only 4 percent learned about the home they actually bought from the *Internet*, as compared to 49 percent who found their eventual home through a real estate agent. Nevertheless, when the association undertakes a similar survey later this year, officials expect the number of buyers of *Internet* properties to rise to reflect the overall increase in *online* real estate searching.

"It's a great tool that allows buyers to start the process, and it builds the excitement," said Brian Marino, a sales agent with National Homefinders in Ronkonkoma.

Robert Zakem is among buyers who did see both his East End house and Manhattan apartment *online* before purchasing them. In November 1997, toying with the idea of buying a home in the Hamptons with his partner, Richard DeFeo, Zakem began checking out real estate sites "just to see what the prices were."

His Web search led him to a 2,500-square-foot Sag Harbor house, with four bedrooms, three baths and an in-ground pool, priced at $479,00. The following June, when he saw that the house had been reduced to $429,000, Zakem and DeFoe, lawyers, drove out to see it in person with David Butland, a sales agent with Cook Pony Farm in Southampton.

The next week, they returned to the house for one more look and decided to buy it. After renovating the property, Zakem and DeFoe moved into the house around Christmas 1998.

Then, last October, Zakem's casual *online* perusals led him to Corcoran Real Estate's Web site where, in the new development section, he unexpectedly found their new Manhattan residence: a two-bedroom, two-bath, 2,050-square-foot condo in Tribeca, which they bought for about $1.4 million. Zakem subsequently listed their Upper East Side condo, a two-bedroom, 2 1/2-bath, 1,400-square-foot apartment, with Douglas Elliman Real Estate. The apartment was sold through the Web for $1.2 million.

"The Web has been very good to me," Zakem said.

The *Internet* is also helping an increasing number of renters.

For instance, computer systems analyst Michael Broggy found his rental apartment via Rent-Direct.com in February. The service allows users to see rental listings, including apartment photographs, for free, but they must pay a registration fee of $169 to access building addresses and landlord phone numbers. Users set up their own appointments and meet with building rental agents on their own.

While the user's registration has no expiration date, most people "fall out within 60 to 90 days," said Ralph Barocas, a partner in the Manhattan-based *online* service.

Broggy was logging onto Rent-Direct.com for three weeks before he paid the registration fee to see the first apartment that interested him - a $1,150-a-month, one-bedroom unit in Woodside, Queens, which he wound up renting.

"I got my money's worth," Broggy said.

For brokers, though, the Web can be a mixed blessing. While the *Internet* enables real estate agents to increase their exposure and extend their reach to the global marketplace, updating Web sites and responding to cyberspace inquiries can be very time-consuming, experts say. What's more, many e-mail inquiries are from people who are more curious than serious about buying a home, they say.

"The *Internet* puts pressure on most agencies because it wastes their manpower," said analyst Sterling of Jupiter Media Matrix.

About 1 1/2 years ago, Marino of National Homefinders joined *Internet* service Homegain.com, which provides brokers with free sales leads through the Web. Prospective buyers electronically submit a form to Homegain, indicating the communities and ZIP codes that interest them, and the service then forwards it to brokers who service those areas.

Since January, Marino has received four to five leads a week, yet only one has materialized into a real estate transaction. In general, Marino said, he doesn't answer half of the inquiries he receives because the senders' housing demands are outrageously unrealistic: as in a "four-bedroom, two-bath home for $70,000" on Long Island.

"I don't know if they have made a mistake, or they are dreamers," Marino said. And, when he does take the time to answer an inquiry, the recipients don't always read his response. With Homegain notifying Marino each time a prospective buyer opens his sent e-mail, he noted that more than 30 percent of his responses go unread.

"Still, nothing ventured, nothing gained," he said.

Similarly, buyers aren't necessarily serious about securing *online* financing when they log onto mortgage sites. According to Fannie Mae's 2000 National Housing Survey, although 21 percent of recent homebuyers used the *Internet* to price a home loan, only 4 percent applied for a mortgage *online*, with 2 percent using the Web to actually secure their loan.

When Zakem was purchasing his Manhattan condo, he checked out mortgage terms at LendingTree.com and applied for a Washington Mutual mortgage application *online* before going to a Great Neck broker he already knew. Zakem said that if he didn't already have a relationship with a broker, he would have pursued the *online* mortgage process without hesitation - a position that makes him more the exception than the rule among mortgage borrowers.

According to Forrester Research in Cambridge, Mass., many buyers go the off-line route simply because they feel more comfortable having personal interaction in large financial transactions.

"We equate it to people taking a while to get used to doing business *online* or initially being concerned about using ATMs," said Kalen Holliday, a spokeswoman for Manhattan-based MortgageIt.com, a 2-year-old Web site that was spun off from IPI Skyscraper, a bricks-and-mortar mortgage brokerage firm. "It's an evolution."

Aware of consumers' concerns, MortgageIt.com, like other *online* mortgage brokers and bankers, responds to e-mailed application submissions with a phone call to assuage any concerns people have about doing business in cyberspace. Borrowers also have the choice of receiving their documents overnight or meeting with a lending agent in person, she said.

With varying degrees of success, other types of real estate-related businesses are also generating business from the Web.

With a 5-year-old Web site and links to other sites, David Klein, owner of the Bayside, Queens-based insurance agency that bears his name, credits the *Internet* with generating 10 percent of his business - a small amount, given that there's "a lot of work involved," as in "site management and development taking more time than you realize."

Last year, one of his sites attracted 50,000 visitors, with 10 percent submitting a questionnaire and 1 percent becoming a client. "It really filters down quite a bit," he said.

About 1 1/2 years ago, Paul Forsberg, vice president and principal in East Hampton-based Stepping Stone Construction, which mostly builds modular homes, started promoting his business on the Web, an effort that initially produced 90 to 120 cyberspace inquiries a month but only a handful of jobs. In many instances, people either weren't serious about building, didn't have the finances to do so or weren't within his service area, he said.

"We go as far west as Riverhead," Forsberg said.

Still, Forsberg doesn't believe the $1,500 he pays annually to maintain and update his Web site is misspent money, even though he says he's received only a few inquiries and no jobs in recent months because of the stock market's volatility.

"All I need," he said, "is one job to pay for it." The Top 10 Real Estate Sites in May Total number of unique visitors to real estate sites: 14,402,000 1. Homestore.com sites Unique Visitors: 4,177,000 Offers shopping list of resources, in-cluding subject links to Realtor.com, new homes, moving, home improve-ment, apartments and rentals. 2. Realtor.com Unique Visitors: 3,606,000 Official site of National Association of Realtors, with features and tips for buyers and sellers and more than 1.5 million home listings nation-wide. 3. Homeadvisor.com Unique Visitors: 3,016,000 Microsoft Network's real estate site, in-cluding home and apartment listings, resources for home improvement, mov-ing, gardening and financing. 4. MonsterMoving.com Unique Visitors: 1,708,000 Offshoot of monster.com, the site of-fers array of moving-related content as well as access to Homestore list-ings. 5. Ahamembership.com Unique Visitors: 1,253,000 Official site of American Homeown-ers Association, offering members an array of products and services, in-cluding discounts on furniture, ho-tels and airline tickets. 6. Springstreet sites Unique Visitors: 1,084,000 Offers 6.5 million apartment listings nationwide, with links to Home-store. com. 7. Homefair.com Unique Visitors: 867,000 Resources for consumers planning, researching and managing a move. 8. Homegain.com Unique Visitors: 800,000 Offers sellers resources to estimate home value, find agents and prepare for selling their properties. 9. Bamboo.com Unique Visitors: 637,000 Through iPIX software, offers "virtu-al tours" of properties through links to Homestore.com. 10. Apartmentguide.com Unique Visitors: 628,000 Offers apartment listings nation-wide, as well as information for apartment dwellers, including re-sources for furnishing, moving/stor-age and finding roommates.
GRAPHIC: 1) Photo - Marcella Connolly sits in the backyard of the four-bedroom, three-bathroom home in Northport that she found with the help of the *Internet*. The house cost $430,000. 2) Photo'sby Ghazalle Badiozamani - Connolly found her new home in Northport while she was living in Brooklyn, with the help of

real estate 3) Photo - Web sites. She used her computer to find out how much she and her husband could afford, compare prices and research school districts. Chart - The Top 10 Real Estate Sites in May (see end of text).
LOAD-DATE: July 13, 2001

Evidentiary Exhibit 54

The Journal Record (Oklahoma City, OK)

April 27, 2001 Friday

SECTION: NEWS

LENGTH: 1496 words

HEADLINE: Independent real estate co. in Okla. City joins national firm

BYLINE: Ray Dozier

BODY:

Brand identity is a vital element of a successful business. That's why after 30 years of owning an independent real estate company, Mike Jones, owner, president and CEO of Mike Jones Company Realtors, decided to strengthen his company with a new affiliation. Last August, Jones' real estate firm joined with Coldwell Banker.

After extensive research, Jones discovered that buyers and sellers were increasingly looking for a real estate firm with a good reputation.

"I had seen buyers and sellers, customers and clients were going toward a brand recognition," Jones said. "More and more people understood a national brand. We were well known, well respected in Oklahoma and metropolitan Oklahoma City, but outside that we weren't known by people in other areas."

The *Internet* was also an inducement for Jones to affiliate with Coldwell Banker. He said more people search for a home on the *Internet* and will look for a company they have heard of or had a previous a business relationship with.

"They come from other parts of the country to metropolitan Oklahoma City, they're used to doing business with Coldwell Banker," he explained. "They like Coldwell Banker. It's earned its reputation. So when they come to Oklahoma they feel comfortable dealing with Coldwell Banker here because of the reputation and the professionalism that goes along with it."

Since joining with Coldwell Banker last summer, Jones said his business has increased about 24 percent. Much of the increase is due to referrals from outside Oklahoma for people relocating to the state.

Jones said Coldwell Banker spends millions of dollars on marketing brochures, ideas and strategies, which is vital in preparing his sales associates to encounter new challenges.

"It would help our sales associates and our buyers and sellers to sell their properties or buy properties and have the latest information in real estate," Jones said. "We believe we were as professional as any real estate company on the local level, but we needed to grab a piece of the national identity to help our sales associates and our company be prepared to do that.

"We want to grow and we feel we can grow under the Coldwell Banker banner better than we can grow as an independent."

Coldwell Banker is a subsidiary of the Cendant Corp. Cendant's real estate division also includes Coldwell Banker Commercial, Century 21 and ERA. Cendant also has a relocation service -- Cendant Mobility and a mortgage company -- Cendant Mortgage. Cendant also owns nine motels -- Amerihost Inn, Days Inn, Howard Johnson, Knights Inn, Ramada Inn, Super 8, Travelodge, Villager and Wingate Inn and the Avis car rental franchise.

Coldwell Banker Mike Jones Co. has one office in Oklahoma City and another in Edmond. For the past seven years, the Oklahoma City office has been in North Park Mall. Jones said with the growth in sales, he anticipates growth in the number of sales associates, so in order to accommodate that increase the company will be moving its Oklahoma City offices to a new location. The new 5,000-square-foot office will be at 4801 Gaillardia Parkway.

"One of the reasons that we selected that is it's right on the corridor of the (Lake Hefner) Expressway between Meridian and MacArthur," Jones explained. "The city is growing around that corridor."

Each sales associate workstation will have a computer with high-speed *Internet* access. The office will feature two conference rooms, also equipped with computers. In addition to administrative offices, the new location will also include offices for Cendant Mortgage and Cendant Mobility. Capitol Abstract & Title Co. is in the same complex.

Jones said the new location is "designed to allow sales associates to sit down with their customers or clients, prepare the contracts, talk to a mortgage person, or come in to close their loan, sit down with the insurance people or appraisers if need be. It will alleviate the buyers or sellers from having to make multiple stops to get all of the things done that they need to in a real estate transaction."

Jones entered the real estate profession in 1961 with the Harold Jones Co., established by his father, Harold, in 1959. His mother, Virginia, also worked for the company for about 25 years. In 1971, Mike purchased the Harold Jones Co. from his father. That same year, Mike was the first in Oklahoma to earn the CRB (Certified Real Estate Brokerage Manager) designation.

"It's the highest residential broker award given by the NAR (National Association of Realtors)," he said. "There were three different courses, plus a test or two. I had to go all over the country. That opened up a whole different world to me because all I knew was Oklahoma."

Mike served as president of the Oklahoma City Metro Association Board of Realtors in 1979 and was honored as Realtor of the Year that same year.

He was also the first in the state to earn the CRP (Certified Relocation Professional) designation in 1992.

"It's a designation given by the Employee Relocation Council, which is the division that has all the Fortune 500 companies," Jones noted. "It's a class and a test that certifies that you are a professional when it comes to relocation real estate, which is a unique part of real estate because it works with corporate relocations, transferees, and working with large corporations. You have to come up with marketing strategies and know values."

For more than 36 years, the Harold Jones Co. and Mike Jones Co. have been associated with Homequity/Homerica, a real estate relocation firm, which Jones said has also evolved into Cendant Mobility.

"It's not really different than in 1964, except they've grown in numbers," Jones said. They represent about 60 percent of the Fortune 500 corporations. We're pleased we've had that association for 36 years."

One of Cendant Mobility's largest clients is USAA, the largest insurance mortgage entity developed for the military. USAA currently serves nearly 4.5 million members providing auto and property insurance, banking, investments, annuities, life insurance, health insurance, financial planning and mortgages.

"With Tinker Air Force Base and a lot of military people here, we serve that market and have done very well representing them," Jones said, noting that Tinker personnel purchase homes throughout the Oklahoma

City metro area. "They demand a top block service, so we have to strive every day and make sure that we're prepared to be able to provide that service to our customers and clients."

In his 40 years as a real estate professional, Jones has seen good times such as the oil boom of the 1970s and early '80s and the bad times of the oil bust afterwards. He believes the Oklahoma City economy is the best it has ever been because it is more diverse.

"Back in the 1970s and early 1980s we were solely dependent on the oil and gas industry," he explained. "Tinker Air Force Base has grown. We have a large medical presence, which has also grown. We've got a lot of service distribution centers here now -- such as Hertz and Southwest Airlines.

"Our economy has blossomed out because we're not strictly putting everything on a particular industry. We've got a lot of different types of industry " a lot of communications industry."

Jones noted that Oklahoma City's location is ideal being at the nation's crossroads and people are discovering all the positives of the city such as affordable housing, cost of living and a "good community involvement and a good government."

He noted that passage of the right-to-work measure would give the city's and state's economy a bigger boost.

"If you look at what the statisticians, businesses and the economists have said about Oklahoma; they have basically said if we had right to work, we'd be in a position to attract more people," Jones explained. "I have to believe those people who are intimately involved in business versus special interest groups who say we don't need it. If the experts are right, who are involved in business and relocation, they say that one of the factors is right to work."

And contrary to what some people believe, the quality of life in Oklahoma City has changed for the better.

"It really has," Jones said. "That's the exciting thing is to see the positive trend that Oklahoma City and Oklahoma has done in the last 40 years. People really care about their professions here. We've got a good work ethic."

The greatest satisfaction in his 40 years in real estate, Jones said, is the quality of real estate professionals, builders and businesses within the Oklahoma City metropolitan area "have continued to blossom and become more professional in all aspects."

"Our builders give good quality construction, our real estate people are becoming more professional," he said. "They are willing to provide more pertinent information to our customers or clients, buyers and sellers. Their sense of pride in the profession is much stronger today than it was 40 years ago."
LOAD-DATE: May 26, 2005

Evidentiary Exhibit 55

PR Newswire

April 25, 2001, Wednesday

Correction Appended

SECTION: FINANCIAL NEWS

DISTRIBUTION: TO BUSINESS EDITOR

LENGTH: 2888 words

HEADLINE: Homestore.com, Inc. Reports Strong and Steady 1st Quarter Growth; Cash Profitability, Strong Revenue Growth Mark Record Performance

DATELINE: WESTLAKE VILLAGE, Calif., April 25

BODY:

Homestore.com, Inc. (Nasdaq: HOMS), the leading supplier of *online* media and technology to the home and real estate industry, today reported pro forma revenue of $ 118.4 million and pro forma net income, excluding the effects of certain non-cash items, move.com acquisition-related charges and the write-down of certain investments, of $ 4.0 million, or $ 0.04 per share, for the first quarter of 2001, the company's third consecutive quarter of cash profitability.

(Photo: http://www.newscom.com/cgi-bin/prnh/20010425/LAW064LOGO)

"I'm extremely proud of the Homestore.com team for posting a very strong quarter in a very difficult market," said Stuart Wolff, chairman and chief executive officer. "I'm also very pleased with the speed at which we have integrated the move.com acquisition while continuing our track record of strong operational performance."

The company said pro forma revenues for the first quarter increased to $ 118.4 million, up 105 percent from pro forma revenues of $ 57.6 million for the first quarter of 2000, and up 11 percent from pro forma revenues of $ 106.4 million for the fourth quarter of 2000. The company's pro forma gross profit margin was 73.5 percent for the first quarter compared to a pro forma gross profit margin of 64.7 percent for the first quarter of 2000, and 71.7 percent, on a pro forma basis, for the fourth quarter of 2000. Pro forma net income for the first quarter was $ 4.0 million, or $ 0.04 per share. That compares to pro forma net loss of $ 33.7 million, or $ 0.35 per share, for the first quarter of 2000 and pro forma net loss of $ 14.6 million, or $ 0.14 per share, for the fourth quarter of 2000.

Pro forma net income and loss exclude the effects of move.com acquisition-related charges and the write-down of certain investments as well as non-cash charges for amortization of intangible assets, stock-based charges and accretion of distribution obligation, included in other expense. To enhance comparability, pro forma operating results assume that the acquisition of move.com from Cendant Corporation occurred on January 1, 2000.

On a GAAP basis, the company's revenues for the first quarter of 2001 were $ 105.5 million, compared to $ 38.6 million for the first quarter of 2000 and $ 79.0 million for the fourth quarter of 2000. The net loss for the first quarter of 2001 was $ 67.1 million, or $ 0.71 per share, compared to a net loss of $ 29.2 million, or $ 0.39 per share, for the first quarter of 2000, and $ 34.2 million, or $ 0.41 per share, for the fourth quarter of 2000.

Subscriptions generated approximately 64 percent of total pro forma revenues in the quarter while advertising generated approximately 36 percent. The improvement in subscription revenue was due to the increase in the number of professional subscribers of Homestore.com products, including the bulk purchase of lead generation products by Cendant Corporation. The number of professional subscriptions rose to approximately 359,000 at March 31, 2001, a 95 percent increase from the total at December 31, 2000 of 184,000 professionals on a pro

forma basis. Renewals also contributed to the increase in professional subscriptions with the renewal rate consistent with prior quarters at approximately 70 percent.

While the percentage of revenue from advertising declined, the amount of dollars generated by advertising sales remained strong, in part, due to record traffic numbers posted during the quarter. The average monthly number of unique users visiting the Homestore.com network rose to approximately 6.7 million, up 87 percent from the first quarter of 2000 and up 21 percent from the fourth quarter of 2000. Each unique user spent an average of 20.8 minutes per month on these Web sites, down 19 percent from Q1 2000, and up 5 percent from the fourth quarter of 2000. Page views were 1.1 billion for the quarter, up 51 percent from the first quarter of 2000, and up 47 percent from the fourth quarter of 2000. Nearly 1.6 billion properties cumulatively were viewed during the period bringing the cumulative number of properties viewed since the company's inception to approximately 9.5 billion. (Unique users and user minutes are based on Media Metrix data.)

QUARTERLY HIGHLIGHTS

On February 16, Homestore.com completed the acquisition of move.com and related assets from Cendant Corporation. Combining Homestore.com's assets with those of move.com expanded the company's reach and further extended Homestore.com's leadership position. Key assets from the acquisition include the Web sites move.com, Rent Net, House Net, Senior Housing Net, and Self Storage Net, as well as direct marketing company Welcome Wagon(R). The integration of these assets was largely completed in the first quarter of 2001.

Homestore.com continued its clear leadership with consumers by posting record *Internet* traffic numbers in the *online* real estate category. For March, Media Metrix reported the Homestore.com network logged more than 7.1 million unique users while Nielsen/NetRatings reported more than 9.6 million unique users for the same period. NetRatings also ranked the Homestore.com network as the 32nd largest property on the Web in terms of unique users in March, up from 77th at this time last year. In page views, NetRatings ranked the company the 19th largest property *online*, up from 51st at this time last year.

During the quarter, the company continued its focus on enhancing its product offerings to home and real estate industry professionals. In January, Homestore.com purchased certain assets from iPIX, including the license to sell iPIX's Virtual Tour Technology. In March, Homestore.com announced a three-year deal with Kodak to make it easier for real estate professionals to post, preview and edit digital images and virtual tours for *online* property listings. Taken together, these two arrangements will enhance the value of our products to real estate professionals.

In the same way that Homestore.com has offered real estate professionals a number of software tools to help them work more efficiently and connect with their *online* audience, the company has begun expanding similar product lines for the nation's home builders. In February, the company launched "Groundbreaker," a lead generation product specifically targeted to custom home builders, who represent approximately 70 percent of the home building market.

FINANCIAL OUTLOOK

The following statements are based on Homestore.com's current expectations as of April 25, 2001. These statements are forward-looking statements and actual results may differ materially. A discussion concerning forward-looking statements and potential risks and uncertainties that may affect these statements is included at the end of this press release and in the Annual Report on Form 10-K filed with the Securities and Exchange Commission.

For the full year 2001, the company expects to generate pro forma revenues of $ 500.0 million and pro forma earnings per share of $ 0.53. In the second quarter of 2001, Homestore.com expects to generate revenues of $ 122.5 million and pro forma earnings per share of $ 0.11. In the third quarter of 2001, the company expects to generate revenues of $ 127.0 million and pro forma earnings per share of $ 0.16. In the fourth quarter of 2001,

the company expects to generate revenues of $ 132.0 million and pro forma earnings per share of $ 0.21. Homestore.com expects to see gross margins of approximately 75 percent by Q4 2001. For the full year 2002, the company expects to generate revenues of $ 662.0 million and pro forma earnings per share of $ 0.93. Homestore.com expects gross margins to be approximately 76 percent for the full year 2002.

CONFERENCE CALL

The Homestore.com conference call to discuss first quarter financial results and the company's outlook and future prospects will be broadcast live over the *Internet* on Wednesday, April 25, 2001 at 2:00 p.m. Pacific Time (5:00 p.m. Eastern Time). Log on to www.homestore.com, click on "All About Homestore," then "Investor Relations," then "Conference Call," and then "Live Webcast." RealPlayer software is required and is obtainable at no cost. Please connect to the above site 10 minutes prior to the call to load any necessary audio software. A replay of the call will also be available in the same section of the company's Web site. A telephone replay will be available from 7:00 p.m. Pacific Time on April 25, 2001 until midnight May 9, 2001 at (719) 457-0820, conference code 693918.

ABOUT HOMESTORE.COM, INC.

Homestore.com, Inc. (Nasdaq: HOMS) is the leading supplier of *online* media and technology solutions to the home and real estate industry. Through its family of Web sites, the company offers consumers Everything Home(TM) and the world's largest *online* database of homes for sale. The company's category-leading network of Web sites include Realtor.com(R), the official Web site of the National Association of Realtors(R); new homes destination, HomeBuilder.com(TM); Homestore.com(TM) Apartments & Rentals; relocation destination, HomeFair.com(R); and home information resource, Homestore.com(TM). Information in this press release concerning traffic numbers on the Homestore.com network includes traffic on certain other Web sites in addition to those named. Content is also available through the AOL House & Home Channel. Homestore.com, Inc. also develops and sells technology to help home and real estate professionals connect with their *online* audience and work more efficiently. For more information log on to: http://www.homestore.com/allabout.

For further information, please contact: Media, Karen Fulton, 805-557-2661, karen.fulton@homestore.com, or Gary Gerdemann, 805-557-3597, gary.gerdemann@homestore.com, or Financial, DeLise Keim, 805-557-2599, delise.keim@homestore.com, or Joe Shew, 805-557-2426, joe.shew@homestore.com, all of Homestore.com, Inc.

Forward-looking statements

This press release contains forward-looking statements that are subject to material risks and uncertainties. Investors should not place undue reliance on these forward-looking statements, which speak only as of the date of this press release. Actual results may differ materially and reported results should not be considered as an indicator of future performance. Risks and uncertainties that may affect our future results include, but are not limited to, the following: our ability to maintain and manage favorable agreements and relationships with the National Association of Realtors, the National Association of Home Builders, other individuals and entities in the real estate professional community, and *Internet* portals; our ability to continue to obtain a large percentage of available real property listings; our ability to obtain such listings on an exclusive basis; acceptance by consumers and real estate professionals of our business model; our ability to manage rapid growth, both internally and through acquisitions; the success of strategic alliances and joint ventures that we enter into; changes in the real estate markets; seasonality and other fluctuations in the company's financial results; our ability to maintain high reliability for our server-based Web services; and uncertainty as to the timing and amount of future *Internet*-related revenue and profits. The matters discussed in this press release also involve risks and uncertainties described from time to time in our filings with the Securities and Exchange Commission

(SEC). In particular, see "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2000 filed with the SEC. We assume no duty to update the information in this press release if any forward-looking statement later turns out to be inaccurate.

Homestore.com, Inc.
Consolidated Statements of Operations - Pro Forma Basis
(in thousands, except per share amounts)
(unaudited)

For the Three Months
Ended March 31,
2001 2000

Revenues $ 118,438 $ 57,640
Cost of revenues 31,345 20,342
Gross profit 87,093 37,298

Operating expenses:
Sales and marketing 56,730 54,093
Product development 5,599 2,252
General and administrative 27,438 19,087
Amortization of intangible assets 54,347 53,223
Stock-based charges 22,320 12,175
Acquisition-related charges 7,065 3,250
Total operating expenses 173,499 144,080
Loss from operations (86,406) (106,782)
Interest income, net 4,430 4,409
Other expense, net (12,621) (14)
Net loss $ (94,597) $ (102,387)

Basic and diluted net loss per share $ (.89) $ (1.07)

Shares used to calculate basic and
diluted net loss per share 105,843 95,414

Net income/(loss), excluding
certain charges (1) $ 3,970 $ (33,739)

Basic and diluted net income/
(loss) per share, excluding
certain charges (1) (2) $ .04 $ (.35)

(1) Excludes the effect of non-cash charges for amortization of intangible assets, stock-based charges, and accretion of distribution obligation, included in other expense, as well as move.com acquisition-related charges and write-down of certain investments ($ 11.1 million).

(2) Net income per share, excluding non-cash charges, move.com acquisition-related charges and write-down of certain investments, for the three months ended March 31, 2001 was calculated using fully diluted shares. Fully diluted shares for the three months ended

March 31, 2001 was 110,765.

Homestore.com, Inc.
Consolidated Statements of Operations - GAAP Basis
(in thousands, except per share amounts)
(unaudited)

For the Three Months
Ended March 31,
2001 2000

Revenues $ 105,491 $ 38,599
Cost of revenues 27,923 10,560
Gross profit 77,568 28,039

Operating expenses:
Sales and marketing 46,457 29,785
Product development 5,385 1,840
General and administrative 22,381 10,815
Amortization of intangible assets 33,788 8,392
Stock-based charges 21,295 10,814
Acquisition-related charges 7,065 -
Total operating expenses 136,371 61,646
Loss from operations (58,803) (33,607)
Interest income, net 4,451 4,409
Other expense, net (12,796) (14)
Net loss $ (67,148) $ (29,212)

Basic and diluted net loss per share $ (.71) $ (.39)

Shares used to calculate basic and
diluted net loss per share 94,925 74,052

Homestore.com, Inc.
Condensed Consolidated Balance Sheets
(in thousands)

Assets March 31, December 31,
2001 2000
(unaudited)
Current assets:
Cash and cash equivalents $ 284,152 $ 180,985
Short-term investments 19,078 75,295
Marketable equity security 4,459 247
Accounts receivable, net 59,227 44,472
Current portion of notes receivable 7,299 5,598
Current portion of prepaid
distribution expense 46,557 49,140
Other current assets 34,083 23,567

454,855 379,304

Prepaid distribution expense,
net of current portion 145,732 159,226
Property and equipment, net 71,341 45,061
Intangible assets, net 991,052 194,742
Restricted cash 90,000 90,000
Other long-term assets 31,543 50,322
Total assets $ 1,784,523 $ 918,655

Liabilities and Stockholders' Equity

Current liabilities:
Accounts payable $ 35,257 $ 13,473
Accrued liabilities 85,156 49,235
Deferred revenue 76,226 27,090
196,639 89,798

Distribution obligation 193,551 189,848
Other 4,919 4,646
Total liabilities 395,109 284,292

Total stockholders' equity 1,389,414 634,363

Total liabilities and
stockholders' equity $ 1,784,523 $ 918,655

SOURCE Homestore.com, Inc.
CONTACT: Media, Karen Fulton, 805-557-2661, karen.fulton@homestore.com, or Gary Gerdemann, 805-557-3597, gary.gerdemann@homestore.com, or Financial, DeLise Keim, 805-557-2599, delise.keim@homestore.com, or Joe Shew, 805-557-2426, joe.shew@homestore.com, all of Homestore.com, Inc.
URL: http://www.prnewswire.com
CORRECTION-DATE: April 25, 2001, Wednesday
CORRECTION:
In LAW064, Homestore.com, Inc. (Nasdaq: HOMS) Reports Strong and Steady 1st Quarter Growth, moved earlier today, we are advised by a representative of the company that under the "FINANCIAL OUTLOOK" section, second graph, tenth line should read "pro forma earnings per share of $ 0.89," rather than "pro forma earnings per share of $ 0.93," as originally issued.
LOAD-DATE: April 26, 2001

Evidentiary Exhibit 56

e.Business

March 31, 2001

SECTION: Pg.48

LENGTH: 8332 words

HEADLINE: e-BUSINESS REPORT - Home pages.; Moving house ranks as one of the most stressful life experiences and

BYLINE: Alexandra Clarke, partner at Kick-Start Ventures.

BODY:

The *internet* has given the estate agency market an opportunity to re-define itself. And given the hundreds of property sites cluttering the net it's an opportunity many are taking. In an industry that has always struggled to be profitable and efficient the web presents agents with the technology to trim operating costs and improve productivity.

Properties can be advertised across a wider area for less money and viewings can be arranged on-line saving time. Clients can search for properties from the comfort of their home rather than trawling the high street as well as receiving mortgage and legal advice on-line. According to CEO of Propertyfinder.co.uk, Rupert Morley, statistics show that on average it takes five months to find a home, half of which is spent searching. The *internet* could change this forever.

But it's not all good news. There is a divide between off-line and on-line players and the failure of disintermediator, Easier.co.uk has given the traditional estate agents plenty of ammunition for knocking their new competitors. Although most recognise the advantages of the net, they are quick to point out the things it can't deliver such as local knowledge and personalised service. What the off-line estate agents want to say is that they are never going to be replaced, because no matter what the added value a website may bring, people are going to want to view before they buy. Still, on-line players are determined to challenge the establishment and as US big hitter, Homestore.com begins to get a foothold in to the UK with Move.co.uk, it is clear the competition will be fierce. Many estate agents are already saying there is a move towards consolidation in the market and it's quite clear why. While the *internet* has given start-ups the power to challenge the establishment it doesn't give them the properties.

This report examines how the net is affecting the estate agency market, how it operates and the implications it has for homebuyers.

THE ON-LINE EFFECT

The web is awash with property-related information. According to on-line directory, Ukpropertyguide.co.uk, well over a hundred sites cater for both the residential and commercial sectors. The bigger ones style themselves as property portals, pulling together information from a range of third party sources, such as estate agents, or the property pages of newspapers.

The best sites offer a formidable resource to anyone seeking to rent or buy property. For instance, Asserta.com focuses on the residential market and currently lists around 200,000 properties. The company claims that a third of Britain's estate agents contribute to its database. Also drawing on the books of agents, rival Rightmove offers around 180,000 listings. Taking a slightly different approach, Fish4homes posts ads that also appear in regional newspapers and boasts around 30,000 entries.

Consumers can carry out huge amounts of research. By logging on to one of the sites and keying in a few specifications (price, location, etc), the potential buyer can assess the market and compare prices across a range of locations and agents.

"People are using the web to do their investigations; they are more informed," says Joel Balodis, business development manager of Ukpropertyguide publisher, UK Net Guides. Balodis believes the net is empowering property seekers.

"They can collect all the information they need before putting in an offer."

The information on most of these sites extends well beyond property listings, such as advice and contact details covering areas such as mortgage lending, insurance and conveyancing.

"Education is key," says Mike Simon, managing director of property portal operator, Move Europe. If consumers don't know about the market, if they need to find a home or locate services such as conveyancing, then the benefit of the net is he can go to a single source and find all that information.

Simon says this one-stop-shop approach, although common in the US, is new to the UK and is being introduced by the web.

This creates business opportunities for the portal operators. The housing market generates huge amounts of economic activity before and after the signing of a rental or purchase agreement. From mortgages and insurance through to the purchase of furniture, there is a huge market here that is largely lost to traditional estate agents, and portals can hope for a slice.

"We can build a relationship," says Simon. "We provide a service relating to the home/living experience."

Ultimately that could mean providing web users with information on local doctors or schools, through to e-commerce partnerships with financial service providers and e-tailers.

According to research published by Rightmove, portal sites are also paying dividends for estate agents. In a survey of 150 partner agents, the company found 97% reporting an increase in inquiries as a result of posting on the Rightmove site.

Estate agents remain firmly in the picture. Once a potential buyer locates a property on-line, the next step is likely to be a phone call or e-mail to the agent who placed the listing. This is unlikely to change much.

Most portals rely on agents to provide their vital listings and cannot afford to anger them.

"The home buying transaction cannot move on-line," says Simon. "E-commerce in transactions will create a lot of animosity with agents."

In other words, the *internet* is not a threat to agents, it is another advertising channel.But if the underlying relationship between agents and their customers is little changed, then is the *internet* having any real impact on the property market?

IMPROVING A LOT

Balodis believes that greater access to information is likely to improve the lot of those seeking to buy or rent. A home seeker might look out of area to compare prices and local facilities and look for bargains. Balodis sees this driving down prices.

Bob Thompson, e-commerce partner with conveyancing and property consultancy firm, King Sturge is not so sure: "The residential market is parochial. People tend to stay within geographical areas. There is no real demand for national services."

Thompson sees more opportunities in the commercial sector, where companies looking to buy or rent commercial space may find that the *internet* is a vital tool in terms of finding suitable properties at competitive prices.

All this points to a market that is still finding its feet. Estate agents will only place ads (even free ads), on portals that can deliver leads.

At the same time, consumers are unlikely to be attracted to sites with comparatively few properties on offer. There is general agreement that only a few players can survive and be viable. The race is on to achieve critical mass.

THE MARKET

The proceeds of the property market are primarily divided between estate agents and mortgage lenders, with the government, legal and structural experts also taking a slice of each transaction. There are currently more than 21 million dwellings in England alone, where the average house costs close to (GBP)100,000, which makes the property sector one of the most important to the UK economy.

Demand for all forms of property is intense. In England and Wales, 61% of the dwellings are rented, but in London where house prices make it difficult to buy, 70% of living accommodation is rented, according to the Royal Institution of Chartered Surveyors (RICS). Bradford & Bingley, in its 2000 Housing Market Review, found that 19% of properties in the UK are let within a week or less, with 82% of accommodation being filled in six weeks or less. There are six buyers registered for every home for sale, including a high of 24 for each house priced between (GBP)200,000 and (GBP)250,000 in Scotland. This has pushed prices up as 97% of offers reach the asking price.

HIGH FIGURES

In October 2000, Halifax estimated the price of a house in the UK stood at (GBP)86,121, while Nationwide estimated (GBP)81,036. Prices rose by more than 9%last year. In 1995, the average cost just over (GBP)50,000. The RICS expects house prices to continue to rise well into 2002 because of a stable economy.

Around 1.5 million houses were sold in the UK last year, although this is expected to drop to 1.4 million this year, according to the Abbey National.

If prices and sales continue at their present rates the turnover for 2001 will stand at around (GBP)130billion. After the boom of the late eighties where the number of house sales exceeded 1.5 million, property prices and sales dropped in the early nineties, reviving in recent years. Relatively, prices remain below the halcyon days of the late eighties.

The Halifax claims to be the largest mortgage lender in the UK with a 19% share. In 1999 it lent (GBP)17billion. According to the Council of Mortgage Lenders, Halifax Plc had a balance of (GBP)93billion outstanding in December 1999. This figure rose from (GBP)83.7billion in 1998. So, it can be assumed that the company has a balance in excess of (GBP)100billion being repaid to it. Second on the list is the Abbey National, which, in 1999, had an outstanding balance of (GBP)64.9billion. Lloyds TSB, Nationwide BS and Woolwich make up the rest of the top five, with the Alliance & Leicester, Barclays, National Westminster, Bradford & Bingley and Northern Rock following. The top ten had a total of (GBP)357.4billion owed to them in 1999.

The leading estate agency group, Countrywide Assured recorded a turnover of more than (GBP)85million for that side of its business. With an average commission of 1.8% and the total number of houses sold topping 40,500 - a 3% fall on 1999 - it could be estimated the company made around (GBP)62million when using the average price of a house in the UK. However, as Countrywide is concentrated primarily in the South East, where house prices are around 15% higher on average, its commission from house sales was higher.

According to figures from Estate Agency News' finance expert, Mike Goodman, the estate agency side of Countrywide Assured group made a (GBP)2.9million profit in the half year to 30 June 2000. Royal & Sun Alliance's property services, on the other hand, made an (GBP)870,000 loss in the first half of 2000 compared with a (GBP)2.14million profit for the same period of 1999.

Your Move, which was formerly known as Commercial General Norwich Union (CGNU) and is number six on the list, made a (GBP)27million first half loss, Goodman says, although (GBP)12million of that was attributed to brand building and investment in the Assertahome website. Also, the General Accident side of CGNU does not include its financial services income in these figures.

Goodman attributes losses to increased competition from independents, the fall in sales of endowment mortgages and investment in e-commerce initiatives. But he cites the government's 'seller packs' as being likely to increase the number of sales. The packs will involve sellers having to pay for surveys on their house before putting it up for sale. This is likely to deter speculative sellers, who want to know how much they can make from their property.

MAJOR PLAYERS

Countrywide Assured launched its website, Rightmove.co.uk in February 2000 and just four weeks later it had signed a partnership agreement with big competitors, Royal Sun Alliance, Halifax and Connell Estate Agents. The deal meant the country's three leading estate agents had come together in an unprecedented move.

Rightmove has the exclusive rights to each of the estate agencies' properties while leaving them free to develop their own sites, such as Royal Sun Alliance's Wheretolive.com. Rightmove has attracted around 500 independent agents as well as several other smaller chains. Altogether the site now boasts a database of more than 180,000 properties and links to around 2,900 estate agents in the UK, covering 99% of the country.

Spokesperson for Countrywide Assured, Kathy Ainger says the site offers consumers a massive amount of choice which is generating around 300,000 visits per month. In addition to advertising properties on-line, the site has a variety of other services. These include property news as well as offering surveying and conveyancy on-line. Rightmove also gives hints on moving as well as explaining some of the legal jargon attached to the sale of a house. But according to Ainger, the main benefit to customers is that they don't have to trawl the equivalent of an electronic high street to find the properties they are looking for. She says the removal of this initial legwork saves time and money as well as removing some of the hassle associated with looking for a home. Visitors to Rightmove can create their own personal file with details of the properties they are interested in, then with a single click they can request further details of the houses along with arranging viewing via e-mail. Ainger adds that the agents also benefit from this because it gives them another vehicle to market properties outside of traditional avenues.

Ainger also points out that Rightmove signals a mood of greater collaboration between competing agents that would have been unthinkable a few years ago, indicative of the consolidation of the industry as a whole. While the *internet* has enabled many start-up companies to compete with leading agents, Ainger says many of the smaller ventures are now looking to be bought out or merged with larger operations. There is likely to be

continued pressure to compete in the sector as websites try and attract as many agents as possible to maintain their position in the market.

Other big high street agents include Bradford & Bingley Estate Agents, the UK's fifth largest estate agency with around 384 UK branches. Part of the Bradford & Bingley Group, the company's website offers a property search facility as well as advice on conveyancing, mortgages and insurance.

The service also recently launched on Freeserve's property channel.

Your Move is the estate agency division of Norwich Union and like many of the other agencies tied to financial and insurance institutions, its site offers mortgage and insurance advice.

Spicer Haart is Europe's largest independent estate agent and has 279 branches in the UK. The group comprises Haart, Spicer Haart, Felicity J. Lord estate agents, Mortgages Direct and HC Wolton & Son surveyors.

The TEAM Association is the UK's largest association of independent estate agents with around 525 members. For the past 20 years the association has enabled estate agents to promote properties across the organisation using intranet technology and for the past six of these the general public has been able to access the organisation's database through the *internet*.

According to chairman, Philip Muzzelwhite the *internet* provides TEAM's members with another avenue other than the regional press to advertise properties. However, Muzzelwhite takes the rather dour view that the site is unlikely to offer anything else as the organisation is not keen on selling other people's services. He also adds that pure on-line players are unlikely to make an impression on the industry as "They are not doing what 98% of estate agency is about".

Internet player, Fish4homes, part of the Fish4 brand, launched with around 30,000 properties posted on its site. The service includes daily property news, legal advice, mortgage information, an estate agents' directory and locator mapping for properties. Visitors to the site can also register search criteria with the site so they can be contacted automatically if a home becomes available that fits their requirements. The site has been developed by six regional newspaper groups.

US COMPETITION

Move.co.uk is another big *internet* player and marks the entrance of the US into the UK market. Homestore.com paid $ 715million for its rival, Move.com towards the end of 2000 in a deal that created the largest real estate service in the US.

The merger of Homemovers with content provider and property channel, Property-On-Line has created a (GBP)17million company with global ambitions.

Owned by Leighton Group, Property-On-Line provides content to the Beeb.com's property channel.

08004homes.com hold around 170,000 properties on its database through a series of partnership agreements. Most notably the site has an agreement with Legal & General, the UK's eighth largest estate agency which lists around 30,000 properties on the site. 08004homes also has a deal with property portal, Homes*online* and recently signed a deal which makes it one of Freeserve's leading information providers for the ISP's property channel. 08004homes is one of On Digital's preferred partners for its home and lifestyle portal.

STRATEGIES AND TACTICS

According to the British Market Research Bureau (BMRB), property sites attract only a small percentage of the UK's on-line population. In its last *Internet* Monitor report, published in November last year, the bureau found that just 2% of those taking part had accessed information on property during the six months of the survey.

That doesn't tell the whole story. While a book lover might make two or three purchases a month, the average residential property buyer will leave seven years between transactions. During the intervening period, he or she is unlikely to have much interest in the market. On the other hand, it is a fair bet that those who are scouring the net for property details are at the very least thinking seriously of buying or renting.

This provides property portal operators with a genuine commercial opportunity to reach a very tightly defined and high spending audience. The problem is, of course, that with more than one hundred residential and commercial sites operating, individual ventures may struggle to build an audience.

"Everyone is trying to build a critical mass," says Henry Phillips, operations manager at Commercial Property Portal UK.

Property portals must build relationships with information suppliers such as estate agents, and potential e-commerce partners. They must also attract users. "It's about building brand," says Mike Simon of Move Europe.

"It's very hard for the average consumer to establish the differences between portals."

A newcomer to the UK market, Move has earmarked (GBP)10million for advertising.

Asserta Homes, thought by many to be the market leader, has spent heavily on a TV campaign and is currently broadcasting property listings on interactive TV. Close rival, Rightmove is also poised to begin a TV campaign. However, Joel Balodis of Ukpropertyguide.co.uk believes that on-line marketing is the best way forward: "If you are an on-line business, the best way to attract your customers is on-line - you don't see too much off-line spend anymore."

With that in mind, UKpropertyguide and its sister, Londonpropertyguide are styled as portals to the portals. By rating and listing property sites, they aim to become a first port of call. The mass-market portals are also in on the act. For instance, Freeserve's property pages are created in partnership with Bradford & Bingley.

Most of the big portals charge estate agents nothing to place a basic listing, but there is money to be made from offering agents an enhanced service. This could mean adding pictures or maps to text or building a branded web presence for the agent in question.

According to Henry Miller of Egpropertylink, enhancing the basic text can have a dramatic impact on the response rate. "Entries with pictures get a nine times greater response rate than pure text entries."

Individual estate agents and chains are also looking at ways in which technology can enhance the effectiveness of their web advertising. A popular feature is the walkaround tour. Using multiple photographs, these applications enable web users to view houses room by room in a simulated three-dimensional format. Thanks to UK start-up, Kubix, agents can now offer full video walkarounds from terminals and plasma screens in their offices. According to Kubix managing director, Dominic Speelman, this is much more than a gimmick. "It's an instruction-getter. View-to-offer ratios come in at about 15-1 to 10-1. We can bring that down to about 3-1," he says.

Mortgage lenders, insurance providers and conveyancing specialists also stand to benefit from e-business developments. Partnerships with property portals should boost sales.

Stephen Ambler of Countrywide Property Lawyers says it hopes to raise transactions from 1999's figure of 27,000 to more than 60,000 in three years' time. He sees e-commerce as playing an important part in underpinning that expansion. In addition to instructing Countrywide's lawyers via the *internet*, customers should also be able to track the conveyancing process.

"We are looking at a service where customers can see the stage of their transaction. It is appropriate that customers should be able to see their files on-line," he says.

In the commercial sector, the *internet* could have an even more profound impact. Conveyancing and property consultancy partnership, King Sturge has been carrying out research into the possibilities of the medium. E-commerce partner, Bob Thompson sees the net as providing landlords with a medium to deliver more services to tenants, thus maximising revenues from properties. "If you own a shopping centre, there is a whole raft of services you could deliver to people who interact within that space," he says.

Thompson cites examples of companies offering telecomms bandwidth to tenants and providing added value WAP- or SMS-based services to shopping centre users. It is a long way from simply placing ads on a website.

"When you're buying a house, you see every for sale sign that you drive by," says Balodis. "Once you've bought the property you don't stop looking at those signs."

ANALYSIS

With hundreds of property sites already populating the web, Hugh Dunsmore-Hardy, chief executive of the National Association of Estate Agents (NAEA), is calling for increased standards for property portals. He wants to see assurances that consumers can rely on information published on the net's hundreds of property sites. But it is not just out-of-date information he is worried about. Security is a big issue for private sales on-line, with many of the safeguards of a brokered sale removed. Sellers are not guaranteed an accompanied viewing and private vendors are not bound by the Misdescriptions Act. The pay-off for sellers is they pay no commission.

TALKING IT THROUGH

Questionable standards aren't the only reason the NAEA has decided to create an *internet* forum to discuss the issue. It says the explosion of property sites on the *internet* has confused the consumer. "There needs to be a rationalisation. The consumer no more wants to visit scores of property sites than they want to visit 20-30 estate agents in the high street," says Dunsmore-Hardy. In reaction to the numerous independent websites springing up across the web, the NAEA has set up its own *internet* site for its members, Propertylive.co.uk. The site already has around 100 firms signed up and although Dunsmore-Hardy says it still has some catching up to do with some of the other commercial sites available, he is sure Propertylive will be of value to homebuyers. However, he still has some reservations about the pulling power of the *internet*.

"Outside of London the majority of estate agents still get customers the traditional way through footfall, phone and advertising, but I expect as more people gain access to the technology this trend will reverse," he says. "But sites that try to cut out estate agents have had very little effect in the United States. Information isn't necessarily knowledge and estate agents have accrued knowledge and expertise."

Ian Davies, regional business director, Bradford & Bingley Estate Agents agrees. "Virtual estate agents do not claim to offer the whole product that we do - a complete dedicated professional service that markets and ultimately sells clients' homes for the best possible price in the quickest time. Our sales branches bring years of local experience that is gained from first-hand grassroots knowledge. We gauge the correct price and offer sound negotiating and interpersonal skills. Add to this our information on how best to prepare a property for sale,

our advice on mortgage finance, our suggestions on which offer to accept, our behind-the-scenes monitoring of legal formalities and how to deal with potential chain problems, and you can see why we remain confident in our position," he says.

The failure of property site, Easier.co.uk would appear to add credence to Davies' claim that most people still prefer the assurances of a professional and face-to-face contact rather than going it alone. Easier had hoped to cut out the middleman under the slogan 'No commission. No estate agents.

No hassle', unfortunately for Easier there were no customers either. Easier believed it could facilitate private sales by putting buyers in touch with sellers while generating revenues by selling information about its user base. However, Easier found it hard to create revenues and partners were slow to come forward. In the end, Easier has ended up looking for a buyer for its ongoing business while becoming a cash shell in hope of a reverse takeover just nine months after it floated on AIM.

While no one doubts that the net has, and will continue to have, an impact on the industry, very few seem to believe estate agents have anything to fear. What is far more likely is that estate agents will see the net as another delivery channel, not only to advertise their properties but to offer other services such as conveyancing. What appears to be important is that estate agents are seen to be adaptable. Davies describes Bradford & Bingley's approach: "We know how important it is for us to integrate our services so that clients can use the method they prefer to buy or sell homes." He adds that this 'clicks and bricks' approach to marketing means Bradford & Bingley can combine the best of both worlds. Customers have the reassurance of a being able to use a physical branch with real people, or the benefit of being able to deal with a virtual branch at a time that suits 24 hours a day, seven days a week.

CONCLUSION

Estate agents have obviously grasped some of the benefits of the *internet* even if they don't think it will change the fundamentals of their business.

The majority have seized upon the idea of the net as a delivery channel - even at the most basic level it offers an additional advertising avenue.

More forward-looking agents offer additional services such as mortgage estimates, legal advice and conveyancy on their websites. Sites such as Asserta believe building on the estate agent's relationship can create extra revenues with the homeowner. By not abandoning them once the sale is complete and offering additional services such as links to home improvement professionals, it hopes to be able to maintain contact with its customers.

Some agents have seen the *internet* as an opportunity to compete against larger players in the market, as a branch network no longer hinders them.

However, the *internet* has not thrown up any big competitors to the established players and attempts to bypass them have ended in failure. Besides their size another contributing factor to the strength of the big players is, of course, that many are subsidiaries of the leading mortgage lenders.

Given the level of competition, the feeling among the industry is that there has to be some consolidation in the industry and smaller players are already looking to be bought out or merged.

The net can also benefit consumers. Potential homeowners can search for properties without leaving the home, receive information about an area or town and even view 360 photos of the property. Other benefits

include being able to respond to multiple advertisements with a single click and making arrangements for viewing via e-mail. Agents are also making use of distribution channels such as interactive TV and WAP.

But the general consensus of opinion is that people will always want to view a property for themselves. The feeling among agents as well is that people prefer the assurances of a professional when selling a house rather than going it alone. Although there can be no denying that the *internet* offers them great opportunities such as saving money, increasing efficiencies and creating customer loyalty, it is unlikely to change the nature of the business as a whole.

EGPROPERTYLINK PARTNERS FOR PROFIT

Launched in its current form in mid-June 2000, Egpropertylink.com is a property portal focused on the commercial side of the market.

The venture was born out of Propertylink, a joint listings venture set up in 1996 by commercial sector estate agents and surveyors, Insignia Richard Ellis, CB Hillier Parker, Jones Lang Lasalle, DTZ, Chesterton and London and Regional Properties.The EG was added to the moniker when Reed Business Information (publisher of Estates Gazette), added its weight to the project.

As the on-line market developed, the backers of the site detected an opportunity to develop a business based on multiple revenue streams. "The partners got together over a year ago and realised this was an important e-commerce opportunity," explains Egpropertylink operations manager, Henry Phillips. "The commercial property market has an annual turnover of between (GBP)30-35billion. If you can get the majority of commercial property on one site, then revenue possibilities are obvious." The venture was re-launched, offering a free listings facility to anyone with property to sell or let. This would build critical mass, providing a springboard to advertising and e-commerce revenues.

The partners invested in a new database system designed to place all available properties on a virtual grid. This means that when nothing is available in a specified location, the tool will find premises in the immediate vicinity, avoiding the 'search produced no results' message, thereby doing what an agent would do.

Following the re-launch, Egpropertylink has been adding property listings at a rate of around 1,000 a month and at the time of writing, the database was carrying around 11,000 entries. Page impressions are running at an average 200,000 a month and the figure for registered users clocks in at 2,000.

At the moment, there are two main revenue streams. Although basic listings are free, agents pay to include enhancements such as pictures or maps.

The site also sells banner advertising and Phillips claims this side of the business has been very successful. "We can offer a focused group of users. People are after high spending eyeballs and targeted communities," he says. "Our rates are high." Egpropertylink needs to attract both agents and potential buyers and leaseholders. Phillips says the link with Estates Gazette has been extremely helpful in attracting advertisers. To attract potential customers, the company places ads in the regional press and seeks out partnerships. The first of these is Business Links in Surrey. Companies in search of commercial space can search the Egpropertylink database from the Surrey office terminal.

Phillips believes that a strong user base will ultimately attract partners, offering further opportunities to build revenue streams. However, the venture is not alone in adopting this business model. The challenge is to achieve that all-important critical mass.

ESTATE AGENCY AND THE *INTERNET*

Rupert Morley, CEO of Propertyfinder.co.uk says the *internet* benefits both the agent and the house hunter.

Estate agents' processes can be inefficient, arcane and costly, which makes buying a house painful. The web offers estate agency the rare opportunity to re-cast itself in a more profitable form.

The UK residential estate agency market is highly fragmented. There are roughly 7,000 agents, who suffer from a lack of scalability. In turn, this breeds hugely inefficient marketing practices and discourages transparency in the housing market. It currently takes 20 weeks on average to sell a house in the UK.

Many agents rely on revenues from financial services such as mortgages to counter-balance less profitable estate agency practices. However, problems with endowment mortgages will jeopardise these revenues. Some of the lending practices of the mortgage industry have also been criticised for encouraging a 'boom to bust' situation, which will hit agents' pockets in the long run. A radical rethink of working practices is required.

The *internet* clearly benefits agents, as it does consumers. By aggregating their property listings on-line, agents can help to reduce the legwork involved in house hunting. According to the Department for Environment, Transport and the Regions (DETR), half of the average 20 weeks it takes to sell a house is spent finding the right property. Searching on-line can cut down on time wasted viewing inappropriate properties, shorten the time it takes to buy a house and increase sales turnover for agents.

Property sites help agents to streamline marketing. The *internet* cuts out the paper-based inefficiencies of distributing particulars through blanket mail-outs. On-line, the agent can contract out some of the initial work involved in preliminary searches to the consumer. This frees up the agent's time for negotiation. Propertyfinder.co.uk's agents are now receiving 40,000 e-mails from potential buyers each month, and many are sourcing 15% of their transactions from the *internet*.

Greater transparencies in current housing availability and pricing within a given geographical area are also achieved. The net creates efficiencies for agents and improves information flows to consumers.

A property site allows agents to pool the investment costs of creating and maintaining a web presence that enables them to manage effectively an increase of enquiries from on-line customers.

HOMES4U BUILDS RELATIONSHIPS

As any homebuyer will tell you, spending on housing does not begin and end with mortgage repayments and insurance renewals. There is furniture to buy, decorating to be done and those who are feeling particularly adventurous might want to landscape the garden. In other words, the housing market generates a vast amount of economic activity. With the upcoming roll-out of a new generation of *internet*-enabled 'lifestyle cafes', Homes4u aims to provide consumers with a one-stop-shop for property-related goods and services.

Formerly known as Mellor Andrews Residential, Homes4u is a Manchester-based estate agency chain operating across the North West of England.

While the buying and selling of property remains at the core of the operation, the opening of the company's first lifestyle cafe in Manchester Technology Park is intended to open up new sources of revenue while deepening its relationship with customers and clients.

The idea is this. The new cafes - inspired by the Starbucks/Aroma/Costa Coffee model - will also contain computer terminals offering access to lifestyle content. In addition to property listings, visitors to the new outlets will also be able to research and buy a range of goods and services.

The unifying factor is that everything on offer will be related to home purchase or, loosely speaking, home improvement.

For instance, while consumer A might choose to browse a database of available residential property, consumer B might be researching DVD players or buying a sofa on-line from one of a number of e-tail partners.

According to chief executive and chairman, Wayne Mellor, the business model should enable his company to build on its core retail business and establish ongoing relationships with consumers.

"Normally you sell a house and say goodbye to the customer. If you are lucky, you maybe see them again seven years later." The hope is that customers will be continue to use the cafes - or, indeed, the *internet* - to research and buy anything from insurance to a conservatory, thus maintaining the relationship.

Property sales will remain an important part of the mix. Mellor says that e-business tools are already enhancing customer service. Through links with other estate agents through the TEAM network (UK) and Immoeuro (UK and Europe), Homes4u can offer customers information on homes outside its own geographical area.

"Without e-business we wouldn't have the opportunity to offer properties for sale from Lands End to John O'Groats and Europe," he says.

The company is taking a multi-channel approach. The content available through the lifestyle cafe terminals is also accessible via the web on Homes4u.com. There will be property consultants on hand in the cafes and in call centres.

Mellor says his company has invested a seven-figure sum in the lifestyle cafe project, with much of that going in to technology. The first of the lifestyle cafes is due to be launched in April.

ASSERTA OPTS FOR MULTI-CHANNEL APPROACH

Unlike some property sites that launched with the intention of cutting out the estate agent, Asserta Home aims to bring the high street with it. This is perhaps not surprising given that the site is backed by CGNU, the UK's largest insurance group.

Asserta was launched in May 2000 by CGU, as it was before its merger with Norwich Union. It bought home portal, UK Property Gold in January 2000 and aims to become the UK's leading property portal. "There is an opportunity to go in to the market with a quality product," says managing director, Andrew Doyle.

The site launched with a heavyweight ad campaign featuring its own brand icon, Denis (above), a child of indeterminate age who hates being dragged around house hunting. The message is clear: do as much of the legwork on-line before beginning the search proper. "The main thing was to have something that saves time and allows you to do the homework first," says Doyle.

Asserta claims a database of around 200,000 properties, updated every 24 hours from 4,000 estate agent members. Property availability is also important. Doyle says many properties on websites are no longer on the market. Membership is free for estate agents at present, although the company derives some revenue through back-office software sales to agents.

Doyle says Asserta aims to move people smoothly through the house buying and owning process, from search, to buying, to moving and finally living.

Each area is a business opportunity, through contextual advertising or e-commerce commissions.

In a bid to keep people on the site longer, Asserta took over private listings property site, Smove. The acquisition will give Asserta richer content with a more lifestyle and living experience slant, says Doyle.

A weekly e-mail alert, Asserta Bulletin, linking to the magazine section of the site is being introduced. This coincides with a redesign of the site to increase its appeal to women, who are seen as key to directing the house buying process.

Asserta is pursuing a multi-channel strategy through presence on Open TV with local information provider, Upmystreet, which is placing property classifieds on the TV platform. It is also available on Telewest. Doyle says TV fits in well with the brand's family approach. "TV is more communal than the *internet*," he says. Users can also register to receive SMS updates and e-mails.

Figures indicate Asserta serves 6.2 million pages a month and has been visited by 1.24 million people since the launch. The brand has placings on the property channels of AOL, Alta Vista, Lycos, Excite and Freeserve.

Doyle says he is looking at lower tier portals that would benefit from being powered by Asserta, such as Schoolsnet, which already provides a school search facility for the site.

However, he says Asserta is only a facilitator. "The *internet* does not save estate agents fees. You still have to vet and negotiate and the *internet* does not take that away. The estate agent is not going to disappear because house buying is stressful enough already."

IMMOEURO BACKS COLLABORATION

Launched in May of last year, Immoeuro's European Realty System is a business-to-business package aimed at providing estate agents of all sizes with a means to streamline their business processes, forge partnerships with other property professionals and access industry information. "We think the system will give agents the chance to become part of an industry," says Immoeuro executive vice president, Ann Meceda (right).

What does this mean in practice? Immoeuro - a company founded by a mixed group of property specialists and software engineers - describes ERS as a centralised hub that facilitates collaborative commerce in the property sector. The subscription for a single office estate agent is (GBP)69 per month.

An important function is the management of on-line advertising. Immoeuro has established partnerships with a number of main property portals and subscribers can use the system to upload details of properties to these sites. According to Meceda, this enables agents who advertise on multiple portals to carry out updates using just one set of tools. She argues that this has benefits not just for the agents themselves but also for the sites who carry their property listings. "Advertising partners have an opportunity to receive high quality data from agents," she says.

Immoeuro puts great emphasis on the pan-national nature of the network.

In addition to partnerships with UK property portals, notably Asserta and Moneypages, the company has also established links with hubs in Spain, France, Italy and Germany. Basic listings entered in one language can be automatically translated for display on overseas sites and the system also handles currency conversion. The company argues that this enables even the smallest agencies to address an international audience.

It isn't simply a question of advertising. ERS is designed to allow individual agents to establish commercial partnerships with their peers in other countries. This might mean searching each other's sites on behalf of clients.

An agent in Kent might use the network to locate houses in France or Germany.

"We really believe that the property industry is moving towards linking internationally," says Meceda.

The monthly fee also provides access to a database of business intelligence, usually in the form of articles and news items provided by Immoeuro and third parties.

The original version of ERS was aimed specifically at single office agents.

However, Immoeuro has subsequently rolled out a version designed to meet the requirements of chains. Additionally, multi-outlet businesses can connect with each other via an Immoeuro-managed intranet. The cost here depends on the size and requirements of the agency chain in question.

Immoeuro's main revenue stream is from subscription. However, the company also aims to earn money from advertising, syndication of content and a share of e-commerce transactions.

SPACETORENT AIMS TO MANAGE

Launched by Nicholas Shulman (below), a veteran of the housing market for the past 30 years, Spacetorent boasts a wealth of experience in property.

Shulman owned West End estate agents, Anscombe and Ringland before he sold it to Hogg Robinson Property Service in 1987 where he was appointed deputy chairman.

It is hardly surprising that Shulman has a pretty clear idea of how the property industry can best make use of the *internet*. At first glance the site's listing of commercial space and private lettings may seem a little old hat. Loot, Fish4 and the London Property Guide all provide a similar service and it is not clear how the company could hope to make an impact.

Listings are free and Spacetorent only charges a minimum fee for posting a photograph and floor plan in addition to a brief description of the property.

But listings are only part of site's offering. According to Shulman the core business will be property and asset management, one of the main reasons why he chose the rental market. Around 50% of lettings are carried out privately and it is in this particular niche that Shulman thinks Spacetorent can make an impression. He says: "Agents are very good at finding tenants, poor at maintaining property and hopeless when the money gets dealt with." A typical London estate agent will charge 10-17% for finding a tenant and managing a property but the service can quite often be unsatisfactory.

"Two things became apparent to me. The first thing that annoys people the most is that agencies take their fees up front. The second is that if you let for twice a year for ten years you could have 20 different tenants, 20 different agents and 20 different managing agents, although there is no need." Shulman says the problem for landlords is that by the second letting they've probably paid a bill to install central heating that goes wrong three lettings later, it's under guarantee but they have no details because the files don't get passed along. Shulman even says most agents would prefer not to handle management because they don't make enough money from it.

He believes that by offering a property management service for around (GBP)60-70 a month he can attract landlords to the site. Not only will they list their property but they will sign up for property management. The site already manages 800 properties for Capital Tech Plc, which holds a 5% stake in the business. Shulman is confident this number will continue to grow with more than 5,000 properties listed on the site since its October 2000 launch.

He says: "The time when you need your property managed most is not when there's a tenant but when it's empty. By paying on a monthly basis it doesn't hurt your pocket, you can sign up to Spacetorent for an extended

period of time, you can cancel it, but you don't have to change your managing agent." As the company's portfolio of property increases, Shulman hopes to be able to offer a quality guarantee which will attract corporate lettings of residential properties as well as private rentals. Instead of spending thousands of pounds with relocation companies, Shulman says Spacetorent could be used in HR departments to find temporary accommodation for employees.

In the meantime, Shulman is concentrating on developing partnerships with other dot coms and associated off-line businesses, such as removals and insurance. The site is also developing a section for holiday lettings but the next significant step will be its launch on On Digital during the first half of this year.

HOME SWEET HOME PAGE?

Sophie Belcher finds house hunting over the *internet* does nothing to improve her stress levels.

Buying a house - second only to getting a divorce - ranks at the top of the list of most stressful things in life. And my first experience of buying was exactly that. I can still recall the endless evenings spent finding and viewing shabby or unsuitable properties. The hours spent on the phone persuading the estate agent that I would only part with my cash in exchange for a decent property.

Four years later and I am looking to re-enter the market. This time around I am confident that the process will be much smoother and much less stressful.

Why? The *internet*, of course.

Surely now, I will be able to narrow my search to find exactly the property I want, find out all the relevant details and even view pictures on-line before I waste time travelling to see the property. Well that's the theory anyway.

General sites promise a selection of everything available on the net.

But all these do is provide the basic information. Any request for more leads you through to the estate agent's own website and a separate registration and search process.

I then tried the direct approach and went straight to the sites of individual estate agents. I could simply surf the net, searching for all the properties at the local estate agency - without having to deal with the estate agent.

I could type in the amount of money I wanted to spend and the type of property I wanted to buy.

In fact, the search ends up being completely arbitrary. The search criteria don't reflect the subtleties of searching for property. There is no box to tick for 'no more than five minutes to the station', 'walking distance to the shops', 'only purpose built blocks' or any of the other personal preferences we all have.

Having registered on-line, my expectations were to be able to locate suitable properties without having to run the gauntlet of aggressive estate agents. Sadly not.

One site gave me the option to receive information by fax, telephone or e-mail. Having carefully ticked the 'e-mail' option, I was surprised to find my answer machine clogged up with messages from estate agents.

Apparently the branches didn't have e-mail so they had to phone me anyway.

So much for technology.

As much as I hate to admit it, the best estate agent in my experience is the one whose office I walked in off the high street.

- Sophie Belcher is editor of Start Your Own Business magazine and www.startups.co.uk.

LEAGUE TABLE OF RESIDENTIAL ESTATE AGENCY OFFICES 2000
League Rating January 2000
Estate Agency Group Branches
1 Countrywide Assured 741
2 The TEAM Association* 478
3 Royal & Sun Alliance Property Services 430
4 Halifax Property Services 407
5 Bradford & Bingley Estate Agents 384
6 Your Move 340
7 Spicer Haart 279
8 Legal & General Estate Agencies 158
9 Connell Estate Agents 144
10 Reed Rains 139
* Strictly speaking TEAM is an association rather than a company
but as it is branded, it has been included in the main table.
Source: Estate Agency News.

LOAD-DATE: November 1, 2001

Evidentiary Exhibit 57

Business Wire

February 13, 2001, Tuesday

DISTRIBUTION: Business Editors

LENGTH: 5190 words

HEADLINE: Florida East Coast Industries' Fourth Quarter and 2000'S Results Highlight Significant Strategic and Financial Accomplishments

DATELINE: ST. AUGUSTINE, Fla., Feb. 13, 2001

BODY:

-- Successful spin-off from The St. Joe Company

-- Realty: Flagler Development Company's rental revenues rise 12.5 percent to $54.2 million in 2000

-- Railway: Florida East Coast Railway's operating profit increases 9.1 percent to $43.7 million in 2000

-- Trucking: Florida Express Carriers continues expansion of intermodal services with the Railway

-- Telecommunications: EPIK's revenue backlog increases over 450 percent in 2000 to over $180 million; fiber network increases 375 percent to 1,500 lit route miles

Florida East Coast Industries, Inc. (NYSE:FLA)(NYSE:FLA.b) (FECI) announced net income for the fourth quarter ended December 31, 2000 of$5.8 million ($0.16 per share), compared to 1999's fourth quarter results of $11.9 million ($0.33 per share). For the fourth quarter 2000 and 1999, pro forma net income, before EPIK's start-up losses and the realty segment's buildings and land sales, was $8.9 million ($0.24 per share) and $6.6 million ($0.18 per share), respectively.

Net income for the full year 2000 was $25.8 million ($0.71 per share), compared to $40.8 million ($1.12 per share) for the same period last year. Pro forma net income for the full year 2000 and 1999, before EPIK's start-up losses, the realty segment's buildings and land sales, Florida Express Carriers' (FLX) 2000 reorganization costs and certain 1999 special charges, was $37.1 million ($1.02 per share) and $34.5 million ($0.95 per share), respectively.

"FECI's results reflect our focus on improving operating performance while investing for growth," said Robert W. Anestis, Chairman, President and CEO. "The Railway's operating ratio improved to 69.8 percent in the fourth quarter, an impressive performance despite the adverse impact of fuel cost increases. Flagler's fourth quarter rental revenues rose 18.1 percent versus the prior year, while "same store" occupancy hit 94.0 percent at year end versus 89.0 percent a year before. EPIK successfully built out more of its network, added new services and customers, and closed the year with a$184.8 million revenue backlog. In 2000, FECI invested over $270 million in capital assets, financed EPIK's start-up losses, restored active management of its extensive real estate assets and reorganized the trucking business. These actions will support FECI's expectations for substantial top-line growth in 2001." Mr. Anestis continued: "We are also taking actions to moderate the effect on near-term operating performance of reduced demand for rail transportation services which we expect to result from the general economic slowdown."

FLORIDA EAST COAST INDUSTRIES, INC.

CONSOLIDATED CONDENSED STATEMENTS OF INCOME

(dollars in thousands, except per share amounts)

(Unaudited)

	3 Months	3 Months	Year-to-Date	Year-to-Date
	12/31/00	12/31/99	12/31/00	12/31/99
Operating revenues	75,673	90,179	276,276	323,887
Operating expenses	(68,112)	(71,218)	(241,092)	(262,863)
Operating profit	7,561	18,961	35,184	61,024
Other income	2,087	284	7,832	4,986
Income before income taxes	9,648	19,245	43,016	66,010
Provision for income taxes	(3,861)	(7,368)	(17,258)	(25,231)
Net income	5,787	11,877	25,758	40,779
Earnings per share-basic	0.16	0.33	0.71	1.12
Earnings per share-diluted	0.16	0.33	0.70	1.12

(Prior year's results have been reclassified to conform to current year's presentation.)

The results presented below are expressed on a pro forma basis, which eliminates (for all periods) operating results (revenues and expenses) from Building and Land Sales (realty segment) and EPIK Communications (telecommunications segment). Reorganization costs at FLX have been excluded from operating expenses for the Year-to-Date 12/31/00 period. Certain 1999 special charges have been excluded from operating expenses and other income for the Year-to-Date 12/31/99 period.

FLORIDA EAST COAST INDUSTRIES, INC.

PRO FORMA CONSOLIDATED CONDENSED STATEMENTS OF INCOME

(dollars in thousands, except per share amounts)

(Unaudited)

	3 Months	3 Months	Year-to-Date	Year-to-Date
	12/31/00	12/31/99	12/31/00	12/31/99
Operating revenues(1)	64,254	62,203	255,376	245,316
Operating expenses (2),(3),(4)	(51,492)	(51,853)	(203,436)	(195,437)
Operating profit	12,762	10,350	51,940	49,879
Other income (4)	2,087	284	7,832	5,748
Income before income taxes	14,849	10,634	59,772	55,627
Provision for income				

taxes (5,940) (4,041) (22,669) (21,138)
-------- -------- -------- --------
Net income 8,909 6,593 37,103 34,489
======== ======== ======== ========
Earnings per
share-basic 0.24 0.18 1.02 0.95
Earnings per
share-diluted 0.24 0.18 1.01 0.94
(Prior year's results have been reclassified to conform to current
year's presentation.)
(1) Revenues from Flagler's Building and Land Sales, Other Buildings
and Land Sales, and EPIK Communications have been excluded from
all periods presented.
(2) Expenses from Flagler's Cost of Sales for Building and Land Sales
and EPIK Communications have been excluded from all periods
presented.
(3) FLX's reorganization costs of $5.3 million have been excluded from
the Year-to-Date 12/31/00 results.
(4) Special charge amounts of $7.5 and $0.8 million have been excluded
from Year-to-Date 12/31/99 operating expenses and other income,
respectively. Railway Results Fourth Quarter and Twelve Months

Revenues from FECR's railroad operations were comparable (at $41.1 million) with prior year's quarterly results. Overall, carload traffic was down 2.0 percent at 42,288 units, primarily reflecting a decrease in aggregate loadings. Full year aggregate shipments increased 1.5 percent to 111,921 loaded units. Intermodal traffic declined 7.8 percent to 68,754 units during the quarter, resulting from an overall weakening of the economy. Offsetting these declines were the effects of a "fuel surcharge" implemented during the fourth quarter and the continued focus on miscellaneous freight charges.

Exclusive of fuel price variance ($0.9 million), FECR's operating expenses decreased $3.5 million or 11.1 percent as management continued to concentrate on cost saving initiatives. The railway segment's operating ratio decreased to 69.8 percent for the quarter, compared to 75.2 percent in the fourth quarter of 1999. The continued focus on expenses and safety resulted in operational savings of $0.8 million, while prior year's results included a charge of $2.7 million related to a casualty settlement.

"The progress we have made in 2000's financial performance was hard fought as we addressed difficult issues, such as rising fuel costs, operational difficulties within connecting carriers and changing economic conditions," said John McPherson, President of FECR. "As we begin 2001, many of these same challenges exist, requiring our continued effort to manage and enhance traffic levels, recover fuel cost increases and continue cost controls, while keeping awareness for safety high."

For the year 2000, FECR's revenues from rail operations were comparable with 1999. Overall, increased revenues from aggregate carloads have offset decreases in intermodal traffic.

Excluding a 62.3 percent fuel price increase ($5.0 million) and the 1999 special charges ($5.5 million), FECR's operating expenses decreased by $8.6 million or 7.0 percent over 1999. Decreases in expenses included labor and benefits ($2.3 million), car hire ($1.3 million), casualty and insurance ($2.2 million), fuel efficiency

($1.0 million) and other costs, primarily derailment expenses ($1.7 million). Railway segment's operating ratio improved to 73.5 percent, compared to 75.7 percent in 1999 (excluding special charges). On a fuel neutral basis, the operating ratio would have been 70.5 percent for 2000.

RAILWAY OPERATING RESULTS

(dollars in thousands)

	3 Months	3 Months	Year-to-Date	Year-to-Date
	12/31/00	12/31/99	12/31/00	12/31/99
FECR	41,125	41,595	163,141	163,032
RTCC & Deliveries	146	503	1,703	1,867
Operating revenues(a)	41,271	42,098	164,844	164,899
FECR	28,692	31,249	119,774	123,353
RTCC & Deliveries	122	423	1,407	1,541
Operating expenses(c)	28,814	31,672	121,181	124,894
Operating profit excl spl. chgs	12,457	10,426	43,663	40,005
Special charges	--	--	--	(5,476)
Operating profit incl spl. chgs	12,457	10,426	43,663	34,529
Operating ratio excl spl. chgs	69.8%	75.2%	73.5%	75.7%
Operating ratio incl spl. chgs	69.8%	75.2%	73.5%	79.1%
EBITDA incl. spl chgs.(e)	16,138	14,149	58,529	49,148

(a) Included intersegment revenues of $1,677 and $1,298 for the three months ended December 31, 2000 and 1999, respectively, and $5,358 and $4,699 for the year ended December 31, 2000 and 1999, respectively.

(c) Included intersegment expenses of $31 and $32 for the three months ended December 31, 2000 and 1999, respectively, and $69 and $136 for the year ended December 31, 2000 and 1999, respectively.

(e) Amounts do not include EBITDA from FECR's fiber leases and realty activities, which are shown in the telecommunications and realty segments following this table.

(Prior year's results have been reclassified to conform to current year's presentation.)

Looking forward to 2001, FECR expects continuing economic softness to produce lower loadings of automobiles and other economically sensitive shipments. FLX and FECR are each continuing their efforts to work together in order to generate higher intermodal traffic. For 2001, FECR will continue its efforts to identify and bring value opportunities to its freight customers and achieve rate enhancement. FECR intends to continue

cost containment initiatives, such as improving operational performance of the train network and car fleet. Similar to other rail carriers, FECR remains vulnerable to increases in fuel costs.

Real Estate Results Fourth Quarter and Twelve Months

Flagler's rental revenues increased by 18.1 percent to $14.2 million during the fourth quarter, reflecting continued strength in "same store" occupancy and strong leasing activity in product delivered in 1999 and 2000. At year-end 2000, overall occupancy for Flagler's operating properties was 93.0 percent, which has improved from 85.0 percent since the beginning of the year.

At the end of fourth quarter 2000, Flagler held 51 wholly owned finished buildings with 5.3 million square feet located in major Florida markets. These operating properties generated $9.1 million of EBITDA for fourth quarter 2000, an improvement of 4.6 percent over fourth quarter 1999 EBITDA of $8.7 million.

Flagler's "same store" buildings, including 46 operating properties with 4.7 million square feet, generated rental revenues of$11.1 million for the quarter, representing a 7.8 percent increase over 1999's rental revenues of $10.3 million. Rental revenue improvements were primarily attributable to "same store" occupancy increases, which were 94.0 percent at year-end 2000 compared to 89.0 percent in the prior year.

At year-end, Flagler had twelve projects with 1.8 million square feet in various stages of development (408,000 square feet in lease-up stage; 532,000 square feet under construction; 883,000 square feet in predevelopment). Included are two build-to-suit projects in Miami totaling 500,000 square feet. "Our emphasis on pre-leasing and build-to-suit projects is indicative of our perception of a softening of demand in some markets," said G. John Carey, President of Flagler. "With an overall occupancy rate of 93.0 percent, we are well positioned for any uncertainty in the economy that may affect Florida's commercial real estate markets."

Operating profit from real estate sales was $3.6 million for the quarter, resulting from the disposal of several ancillary land holdings at Flagler and FECR. During fourth quarter 1999, real estate sales for both Flagler and FECR generated operating profit of $10.3 million, which included the sale of a Jacksonville business park with 260,000 square feet ($3.6 million operating profit).

For full year 2000, Flagler's operating properties generated $36.3 million in rental EBITDA, representing a 12.0 percent increase over 1999. Included in prior year's results was $2.5 million in EBITDA related to rentals for three business parks sold during 1999. "Same store" rental EBITDA improved by 4.0 percent to $29.8 million for 2000. The improvements in EBITDA were partially offset by additional overhead costs of $1.8 million related to the staff up of Flagler's new management team in conjunction with the transition of responsibilities from St. Joe during 2000. Flagler now occupies approximately 14,000 square feet of space in Jacksonville and currently has 22 employees.

REALTY RESULTS
(dollars in thousands)

	3 Months	3 Months	Year-to-Date	Year-to-Date
	12/31/00	12/31/99	12/31/00	12/31/99
Rental Operations				
Flagler rental revenues(b)	14,157	11,984	54,196	48,179
Flagler operating expenses	12,312	9,679	45,632	37,824

------- ------- ------- -------
Flagler operating
profit from realty
rental 1,845 2,305 8,564 10,355
Other rental revenues 818 767 3,253 2,979
Other rental operating
expenses 109 55 437 355
------- ------- ------- -------
Other operating profit
from realty rental 709 712 2,816 2,624
Buildings and Land Sales
Flagler buildings and
land sales 8,985 27,116 15,692 77,608
Flagler cost of sales 5,394 17,472 7,930 56,650
------- ------- ------- -------
Flagler operating profit
from real estate sales 3,591 9,644 7,762 20,958
Other buildings and
land sales 51 700 1,815 803
Total realty operating
profit 6,196 13,361 20,957 34,740
======= ======= ======= =======
EBITDA from Flagler
operating properties
rents 9,133 8,673 36,279 32,391
EBITDA (loss) from
Flagler land rents/
holding costs (654) (501) (3,092) (2,329)
Equity pickups on
partnership rents (57) 110 78 110
Less: unallocated
corporate overhead (1,744) (1,437) (5,895) (4,046)
------- ------- ------- -------
EBITDA from Flagler
rental properties, net
of overheads 6,678 6,845 27,370 26,126
EBITDA from Flagler real
estate sales, net of
overheads 3,591 9,645 7,762 20,959
------- ------- ------- -------
Total EBITDA - Flagler 10,269 16,490 35,132 47,085
------- ------- ------- -------
EBITDA from other rental 719 732 2,857 2,671
EBITDA from other real

estate sales 51 700 1,815 803
Total EBITDA - real
estate segment 11,039 17,922 39,804 50,559
======= ======= ======= =======

(b) Included intersegment revenues of $37 and $57 for the three months ended December 31, 2000 and 1999, respectively, and $144 and $324 for the year ended December 31, 2000 and 1999, respectively.
(Prior year's results have been reclassified to conform to current year's presentation.)

For the year 2001, Flagler's rental revenues from commercial properties are expected to increase approximately $7.0 to $9.0 million or 13.0 to 17.0 percent over year 2000's results of $54.2 million. EBITDA from Flagler's operating properties is expected to increase 8.0 to 14.0 percent or approximately $3.0 to $5.0 million for the year over year 2000's results of $36.3 million. The growth is expected to result from increases in rental rates from existing buildings and lease-up of buildings completed in 2000. Flagler also expects to continue to pursue disposals of surplus land and improved properties on an opportunistic basis during the year 2001.

For the year 2001, Other Buildings and Land Sales costs will increase by $2.6 million due to a land lease in the South Florida area.

Telecommunications Results Fourth Quarter and Twelve Months

EPIK completed a successful fourth quarter of 2000, with notable accomplishments including expansion of the lit southeast fiber network to 1,500 miles (an addition of 1,100 miles), successful connection of an *Internet* Protocol (IP) network and peering routers at the NAP of Americas, quarterly revenues of $2.4 million, and additions to the revenue backlog of $35.0 million ($184.8 million in total). Revenue from the backlog is recognized over the life of the contract. Even with these accomplishments, EPIK's management team continued its development and execution of previously announced key initiatives. These initiatives include:

-- Metro Fiber Rings

The deepening of EPIK's reach into key markets along its network by developing metro fiber rings in major southeastern metropolitan areas will include up to 40 total sites throughout Atlanta, Jacksonville, Orlando, Tampa, Miami, Daytona and Melbourne. Currently, EPIK has 10 sites in Orlando and Miami ready for service with work progressing on the remaining sites.

-- Collocation (Facilities Expansion)

Expansion of EPIK's collocation business includes development of over 40 sites with approximately two-thirds of the sites in Florida and one-third in Georgia. This expansion will allow EPIK to meet the growing space requirements for dark fiber and capacity customers along the southeastern network.

-- IP Services

During the fourth quarter, EPIK launched IP services between Orlando and Miami on the Florida East Coast segment of its southeastern network and is continuing work to make IP available along the remainder of the southeastern network.

-- Wave Services

In conjunction with the launch of IP services on the Florida East Coast segment of EPIK's southeastern network, wave services were also established along this segment.

EPIK's net operating losses for the fourth quarter and twelve months ended December 31, 2000, ($8.8 million and $21.0 million, respectively) reflect start-up costs, primarily wages, benefits, professional services and sales and marketing expenses, necessary to execute its business plan for the southeast regional footprint and the previously mentioned new key initiatives.

"EPIK continues to make excellent progress in executing our business plan," said John McClellan, EPIK's President. "Our target customer segments, who require high capacity bandwidth for wireless, data and *Internet* services, continue to show strong demand growth, belying the views of pessimistic analysts. We expect to see significant ramp-up in our recognized revenue as we complete the southeast network and our contracted backlog is converted into provisioned services. We are moving aggressively on all of the initiatives that we launched in September 2000. We are seeing strong customer response to our metro services, to our dedicated access to the international cable landing stations in South Florida, and to our innovative *Internet* and wave services. Our fiber swaps have also generated strong demand for collocation space. We are also excited by the continued development of the NAP of the Americas in Miami. In December, we became the first carrier serving the interim NAP, and we are preparing for a leading role when the permanent facility opens this summer. This is a showpiece project for Florida, and we are proud to be at the heart of it."

Telecommunications Results
(dollars in thousands)

	3 Months	3 Months	Year-to-Date	Year-to-Date
	12/31/00	12/31/99	12/31/00	12/31/99
Operating revenues				
EPIK Communications	2,383	160	3,393	160
Fiber Leases	1,567	1,503	6,984	5,271
Total revenues	3,950	1,663	10,377	5,431
Operating expenses				
EPIK Communications	11,226	1,893	24,426	3,289
Fiber Leases	34	66	191	255
Total expenses	11,260	1,959	24,617	3,544
Operating profit (loss)				
EPIK Communications	(8,843)	(1,733)	(21,033)	(3,129)
Fiber Leases	1,533	1,437	6,793	5,016
Total operating profit (loss)	(7,310)	(296)	(14,240)	1,887
EBITDA	(7,179)	(1,724)	(18,649)	(3,120)

(Prior year's results have been reclassified to conform to current year's presentation.)

During 2001, EPIK will continue to focus on the build-out of the southeast network and the new key initiatives announced during the third quarter of 2000. Revenues and EBITDA for 2001 should be in line with prior released estimates of $32.0 to $37.0 million and ($8.0) to ($13.0) million, respectively.

Trucking Results Fourth Quarter and Twelve Months

For the year 2000, FLX's results reflect the restructuring of its operations and improvement of its alliance with FECR to offer complete intermodal transportation solutions to freight shippers moving goods to and from Florida. "While the restructuring of our operations has resulted in a number of costs and restructuring charges, we have already seen positive evidence that this investment is better serving our target customers' transportation needs as 2000's revenues increased 8.9 percent, with traffic interchanged with FECR up 14.0 percent," said Tom Connard, President of FLX.

Fourth quarter 2000 revenues from trucking operations increased 13.2 percent to $8.2 million from $7.2 million in 1999. This increase reflects improved sales efforts resulting in additional customer accounts. Traffic interchanged with FECR improved by 29.2 percent in the quarter.

Fourth quarter 2000 expenses increased 9.4 percent to $9.3 million from $8.5 million in 1999 which includes increased fuel ($0.1 million), as well as higher line-haul costs associated with increased revenue ($1.2 million). There was a decrease in insurance and casualty costs of $0.8 million compared to fourth quarter 1999.

For the year ended December 31, 2000, revenues from trucking operations increased 8.9 percent to $31.6 million from $29.0 million in 1999. This increase reflects improved sales efforts resulting in additional customer accounts. For the year, traffic interchanged with FECR improved by 14.0 percent.

Operating expenses for the year ended December 31, 2000 increased$9.5 million to $39.8 million, reflecting a number of costs and restructuring charges, including expenses associated with relocation of FLX's headquarters from Cincinnati, Ohio to Jacksonville, Florida, as well as force reductions and severance payments, and the addition of new facilities and staff at the new headquarters. The costs and charges also include the restructuring of the existing terminal network, the opening of an additional terminal in Charlotte, North Carolina, and a charge for the impairment of goodwill associated with the original acquisition and operations of FLX. The total amount of the pre-tax charges is $5.3 million.

Excluding the costs and restructuring charges, operating expenses were $34.5 million compared with $30.2 million for the same period last year. Contributing to the increased expenses were general and administrative costs ($0.8 million), increased fuel costs ($0.6 million) and transition costs for the new management team ($0.3 million), as well as higher line-haul costs associated with increased revenue.

Trucking Results
(dollars in thousands)

	3 Months	3 Months	Year-to-Date	Year-to-Date
	12/31/00	12/31/99	12/31/00	12/31/99
Operating revenues	8,155	7,206	31,601	29,011
Operating expenses(d)	9,325	8,520	39,752	30,223
Operating profit (loss)	(1,170)	(1,314)	(8,151)	(1,212)

(d) Included intersegment expenses of $1,677 and $1,298 for the three

months ended December 31, 2000 and 1999, respectively, and \$5,358
and \$4,699 for the year ended December 31, 2000 and 1999,
respectively.
(Prior year's results have been reclassified to conform to current
year's presentation.)

For the year 2001, FLX faces softening economic conditions and potential slowing of industry traffic levels. However, because FLX has refocused on providing railway interchanged services and has positioned itself for growth, it expects to achieve a profitable year with revenues in the \$34 to \$36 million range and increased interchange traffic with FECR.

CAPITAL INVESTMENT During the year 2000, the Company's subsidiaries made capital investments of approximately \$270 million, primarily to improve efficiency and service at the Railway, to further develop Flagler's entitled realty assets, and to commence lighting and provisioning EPIK's southeastern telecommunications network. As a consequence, the net book value of the Company's property, plant and equipment rose dramatically from \$742.2 million to \$989.3 million during 2000 while cash, cash equivalents and passive investments were drawn down from\$102.6 million to \$32.7 million and long-term debt increased from nil to \$88.0 million.

For 2001, the Company's business units plan capital investments in the range of \$350 to \$375 million. The focus will be continued improvements in transportation, development of the real property portfolio, and completion of the southeast telecommunications build-out announced last year. This investment program is planned to be financed through use of the Company's cash balances, bank debt, prudent levels of non-recourse financing for the Company's developed realty holdings, as well as internally generated cash flow. These steps are intended to create an efficient capital structure at the Company, as well as generate funds for its development programs.

Florida East Coast Industries, Inc., headquartered in St. Augustine, Fla., conducts operations through four wholly owned subsidiaries, Flagler Development Company (Flagler), Florida East Coast Railway (FECR), Florida Express Carriers, Inc. (FLX) and EPIK Communications Incorporated (EPIK). Flagler owns, develops, leases and manages approximately 6 million square feet of commercial space and owns approximately 17,000 acres of land, all in Florida. FECR is a regional freight railroad that operates 351 miles of mainline track from Jacksonville to Miami. FLX provides truckload service, intermodal drayage and transportation logistics and brokerage services. EPIK, located in Orlando, Fla., is a carriers' carrier that provides bandwidth capacity, dark fiber leases and collocation services to telecommunications providers.

This news release contains "forward-looking statements" concerning revenues, expenses, earnings, assessments of current industry and market conditions, technology, and prospects for the future. The Company cautions that such statements are necessarily based on certain assumptions, which are subject to risks and uncertainties which could cause actual results to materially differ from those contained in these forward looking statements, including, but not limited to, the ability to complete systems and expand and enhance its telecommunications network within currently estimated time frames and budgets; the ability to compete effectively in a rapidly evolving and price competitive marketplace and to respond to customer demands and industry changes; the ability to achieve revenues from products and services in the telecommunications business that are in the early stages of development or operation; the ability to manage growth, changes in business strategy, changes in regulations and technological changes, volatility of fuel prices and managing the effects of changing general economic conditions (particularly in the State of Florida) as it relates to economically sensitive

products in freight service and building rental activities. Further information on these risk factors is included in the Company's filings with the Securities and Exchange Commission, including the Company's most recently filed Forms 10K and 10Q. The Company assumes no obligation to update the information contained in this news release which speaks only as of the date of this press release.

CONTACT:
Brian J. Nicholson, 904/819-2119

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Evidentiary Exhibit 58

The Washington Times
January 12, 2001, Friday, Final Edition
SECTION: PART F; FRIDAY HOME GUIDE; Pg. F1
LENGTH: 1727 words

HEADLINE: *Internet* helps buyers in neighborhood search

BYLINE: Chris Sicks; SPECIAL TO THE WASHINGTON TIMES

BODY:

Figuring out where you should buy your next home is difficult in any city, but it is particularly challenging in the Washington area. It's a region made up of two states and one would-be state. It is divided by rivers, connected by bridges, crisscrossed with highways and spread out from Frederick, Md., to Fredericksburg, Va., and Ashburn, Va., to Annapolis.

How do any of greater Washington's 3 million residents ever find the right town to live in, let alone the right home to buy?

Most buyers have a few determining factors that help a lot. How much you can afford may be the most important question to ask yourself, but others include: place of employment, location of schools and houses of worship, preference for urban or rural setting, and proximity to mass transit.

Buyers who have lived in the Washington area for some time probably can synthesize these factors into a rough picture of where they want to live. Once they do that, they are ready to find a good buyer's agent and start home shopping.

But what if you are new to the area, as so many Washingtonians are? How do you begin making sense of such a huge area? The *Internet* is a great place to start.

The real-estate oriented Web sites that have sprung up during the past few years are a tremendous help to consumers who want to conduct neighborhood research. Much of the information is general, so you wouldn't want to base your entire buying decision on what is on line. But sites such as Realtor.com, Move.com and Iplace.com provide shoppers who are new to an area a overall sense of how things are laid out.

"Someone who is relocating to a new city often has no clue about where they are going to live," says Jyoti Nanda, public relations manager at Move.com. "Before they can do anything, they will want to know a little about how the different parts of the city compare."

Move.com provides some of the most comprehensive information of all the neighborhood sites, because it is operated by Cendant Corp., the same company that owns Century 21, ERA, Coldwell Banker and Welcome Wagon. By pooling information from these companies, the U.S. Census Bureau and other sources, Move.com is able to offer everything from average utility costs to the frequency of hail storms. School data, demographics, weather, taxes and home-price information are all offered for free.

Visitors also can view home listings in the area they are interested in, but only if the properties are listed by Century 21, ERA or Coldwell Banker. These companies make up 25 percent of home listings nationwide, somewhat less than a complete picture.

This is the kind of shortcoming you will find on almost every real estate Web site. To make money, each site has formed an alliance with realty firms, lenders, movers and other professionals. You may find the help you need, but be aware that most sites aren't showing you everything or everyone out there. (See the "More Info" box for snapshots of several neighborhood-information Web sites.)

The data found on the *Internet* is a great way to begin your house hunt but it often is limited to ZIP codes. Although this gives you more detailed information than county or city data, ZIP codes usually encompass several - if not dozens - of individual neighborhoods that may vary widely.

For example: Even though the average price of a home in ZIP 22314 (Old Town Alexandria) is $325,500, great town homes are available in that area for $200,000. If you look just two miles away, you will find homes for $100,000.

This is where the need for a Realtor becomes so apparent. Even if you are quite sure you want to live in College Park, nothing beats a good buyer's agent who knows the lay of the land and who has your best interests in mind.

"You really need to look at everything available that makes sense for you," says Stephen Israel, president of the Buyer's Edge. "Almost everybody has some factor that is location-related that really helps us zero in. But often, the location they want doesn't match up with what they can afford or the homes that are available."

Especially in today's competitive market, buyers need information on homes for sale, not just neighborhoods. Homes that are on the market sell quickly these days, and the number of properties for sale is very low. Driving around neighborhoods may help you identify a few areas you would like to live, but how do you know what homes are for sale?

"You really have to start with some basic criteria, and then go right to the listings," Mr. Israel says. "We try to establish the broadest possible search criteria -even broader than our clients might initially expect."

Mr. Israel says his average client wants to live near the Metro, spend $350,000 and be near shopping and good schools. Those criteria can be met in hundreds of neighborhoods throughout Maryland, Virginia or the District, so it helps to work with an agent who is licensed in more than one jurisdiction.

"We literally will print every home on the market, often 85 or 100 listings," Mr. Israel says. "We won't, of course, visit all of those homes. But buyers really should take an hour to read through all the listings. If they don't do that, and have their hearts set on Bethesda, they will never learn about the cute little bungalow in Alexandria that is perfect for them."

Once you have found a dozen or more homes that have some potential, a driving tour is a great next step. Whether you go with your agent so you can visit the homes, or if you just drive around to see them from the outside, no *Internet* service can beat a firsthand look at real communities and real homes for sale.

What if you like the neighborhood you drive through, but know nothing about the schools? Questions about schools are often a sensitive issue for real estate agents, because they are somewhat limited in the help they can provide.

"A Realtor should never make limiting choices for a consumer," says Laurie Janik, general counsel for the National Association of Realtors (NAR). "When a client asks to be shown houses near a good school, the agent should ask: 'What makes a school good to you?' For one family a good school might be one with a big athletic program. For another, it might be one offering many foreign languages. It's not the Realtor's job to say: 'This is a good school.' "

Many first-time buyers are surprised and confused when they don't get the answers they want from their agent. The problem is, they are often asking the wrong questions.

Realtors are not allowed, under federal fair housing laws and the NAR's code of ethics, to "steer" their clients' home-buying decisions. Agents sometimes get themselves in sticky situations that could be avoided if buyers and sellers better understood fair housing laws.

The point of all this regulation is to ensure that buyers determine where they will live, not real estate agents.

"Let's say you are a Roman Catholic, and want your children to be able to walk to a Roman Catholic school," Mrs. Janik says. "In this case, you have made all the choices. So your Realtor can mark up a map with red dots, indicating the location of every Roman Catholic church with a school in town. That's not steering."

The problem comes in when the neighborhood of choice is the Realtor's idea, not the buyer's. Realtors should never suggest a church, school or neighborhood based upon opinion or personal experience.

These laws were not, of course, created simply to prevent folks from finding neighborhoods near churches they might like. The fair housing laws exist to prevent, for example, an agent steering a white family away from Hispanic neighborhoods.

Agents cannot respond to your questioning along this line. Don't expect your Realtor to be helpful if you say, "I don't want to live near any" members of a particular minority group.

Many Realtors make certain there's no confusion by handing out brochures explaining the Realtors' code of ethics.

All of these codes and restrictions may seem confusing, but it really is common sense. If you are looking for a home based on fair and reasonable criteria, your agent will be able and happy to assist. If you seek to be bigoted or irrational in your house hunting, don't expect any help.

****BOX

MORE INFO:

* www.schoolmatch.com

For $10, you can order a detailed "report card" on any school. Reports include student density, test score results, spending per pupil and dozens of other useful facts. Limited information on each school also is available for free.

* www.realtor.com

One of Realtor.com's most helpful features is the home-price check, which allows you to view recent sale prices of homes on any street. This will give you a sense of how a home you may be considering compares to nearby properties. The number of bedrooms and bathrooms also are provided if you register with Realtor.com.

Be sure they are similar homes, however, and that they are in similar condition. These subtleties are a real estate agent's forte.

The Find a Neighborhood feature on Realtor.com provides statistical data by ZIP code, so you can compare the affluence, population density, demographics and housing stock of areas you might want to live.

A good deal of information is available, but some of the questions asked by Find a Neighborhood don't seem helpful. For instance, visitors are asked to select the quality of schools they want (1-5) and the level of crime risk they are comfortable with (1-5). Who isn't going to select the best schools and the lowest crime?

* www.move.com

Move.com provides a wealth of information, including demographic information such as population, household income, median age, crime risk and population density; school information that includes test scores and spending per pupil; financial tidbits such as cost of utilities, taxes and insurance; and weather data such as risk of earthquake, hail, snow and rain frequency, carbon monoxide level and average temperature.

The best thing about Move.com is you don't have to register to use the site. Most of the other sites reviewed here required registration before the data are provided.

* www.iplace.com

Iplace.com offers much of the same data as the other sites, plus data on home values and advice about managing your personal information. Requires registration.

GRAPHIC: Box, More info:

LOAD-DATE: January 12, 2001

Evidentiary Exhibit 59

ABI/INFORM

Property Management

2001

SECTION: Vol. 19, No. 2; Pg. 180-206; ISSN: 02637472

B&H-ACC-NO: 269357661

LENGTH: 11669 words

HEADLINE: Market review

BYLINE:

Anonymous

ABSTRACT:

Recent reports and surveys about property management are discussed.

BODY:

Benchmarking building costs

Keywords Benchmarking, Construction management

The latest BCIS Study of Average Group Element Prices presents L/msup 2 group elemental prices for a variety of building types. It provides a very useful tool for benchmarking estimates or actual costs of new buildings.

The tables in the study allow not only the total building cost to be benchmarked but also the five group elements of substructure, superstructure, internal finishes, fittings and services.

Table I shows the average cost per msup 2 for offices for each of the group elements and the total building cost. Figure 1 also shows that the elements representing the highest proportion of costs are superstructure and services, with 47 per cent and 32 per cent, respectively.

The study covers over 100 building types in the following sectors:

* industrial;

* commercial;

* health;

* recreation;

* education; and

* residential.

The BUS Average Group Element Prices Study. Available as part of the BCIS annual subscription service, or individually, priced, L80.00 from BUS, 12 Great George Street, Parliament Square, London SWIP 3AD.

Economies of scale

Larger building projects offer considerable economies of scale, according to the BCIS Study of Pricing Adjustment Factors, published today in the BCIS Surveys of Tender Prices.

The study shows that pricing levels fall quite sharply between a L100,000 contract and a L1 million contract, with the latter being some 12 per cent lower than the former. Economies of scale become less pronounced as the size of contract increases further, with a L5 million project likely to have pricing levels some 9 per cent below that of a L1 million project.

The BCIS Study of Pricing Adjustment Factors shows the pricing levels of a range of factors including:

* location;

* procurement;

* route;

* number of storeys;

* size of contract;

* type of work; and

* building type.

The BUS Study of Pricing Adjustment Factors is part of the BUS Surveys of Tender Prices which also includes an update of the BUS Tender Price Index, the Contract Percentages Study, the Study of Average L/msup 2 Prices and Functional Prices for a whole range of building types. Available individually at L80.00, on subscription at L250.00 p.a. for four issues, or as part of the BCIS Bulletin Service. The Building Cost Information Service, 12 Great George Street, Parliament Square, London SWIP 3AD.

Occupancy cost plan for offices

Keywords Offices, Costs

The total building occupancy costs of offices can exceed L10,000 per 100msup 2 of floor area per annum. The latest BMI Special Report estimates the total occupancy costs of two air-conditioned office buildings over a 20-year period. Even over this relatively short period, occupancy costs are three to four times the initial capital cost. The estimates show that the larger of the two buildings, with a floor area of 3923msup 2 costs 16 per cent less than the smaller building which has a floor area of 763msup 2. Average annual costs per 100msup 2 are L9,415 and L11,240, respectively.

Overheads are the most expensive element in both buildings, accounting for over one-third of the total costs in each case which reflects the importance of business rates. Cleaning, administration and utilities all account for between 10 per cent and 20 per cent of total costs.

Table II shows the elemental costs for each example, and predicts the total occupancy costs over 20 years.

BMI Special Report 294 - Occupancy costs of Offices is available as part of the BMI subscription service, or individually priced L50.00 from BMI, 12 Great George Street, Parliament Square, London SWIP 3AD.

The real issues behind begging

Keywords Housing, Charities, Counselling

National Homeless Alliance (NHA) today welcomes initiatives to bring additional resources to front-line homelessness services. NHA is involved with the Government's "Change a Life" campaign, which encourages the public to support homeless people by offering money, time or gifts to local charities. NHA's role is to

distribute donations made to its members through its groundbreaking new initiative, Homeless Direct. NHA members look forward to receiving donations and offers from the public to volunteer.

NHA welcomes a constructive debate on the issue of begging and hopes it will lead to real solutions to the complex problems many vulnerable people face and a unilateral commitment to achieving them.

NHA and its members urge the public not to focus on negative images of homeless people, but on what they need to improve their situation and what they are doing to change their lives themselves.

NHA appeals to the public to understand why people beg and what problems they face.

Research has shown that most people who beg have experienced severe trauma early in life and are extremely damaged people. The majority find begging an embarrassing and degrading experience and they frequently experience harassment, verbal abuse and in many cases, physical and sexual assault by members of the public.

NHA wishes to avoid people who beg being simplistically divided into the deserving and undeserving on the basis of issues such as their drug or alcohol misuse, as there are many reasons why people misuse substances. Those who have a mental health problem often do so to avoid distressing symptoms; others wish to block out memories of past abuse and trauma and many see it as a coping strategy for the difficulties of life on the street.

NHA members report that current provision of drug and alcohol services are inadequate. Recent research by Crisis showed that 53 per cent of beggars with a dependency were receiving no help with it at all with one-third reporting there was no help at all locally. Of the 47 per cent who were receiving help, a further third did not find it useful.

Dominic Fox, Chief Executive of National Homeless Alliance, says:

We have to ensure that no person begging is demonised through this debate and that all vulnerable people have access to adequate support when they need it.

The waiting times for detox are simply unacceptable. If you can't get people in as soon as they are ready, they're often tempted or persuaded to take drugs and are back to square one.

Access to one week detox, which relieves initial physical dependency, is not the primary issue. The limited availability of rehab which takes a long-term approach by changing people's thinking about themselves and their drug use is the major problem. Also, because they move around a lot, homeless people cannot satisfy local connection rules in any local authority area which they must have before the council will fund their rehab. This barrier should clearly be removed.

Research has shown that outreach provision is currently inadequate and only half of the people on the street have been approached by them. If we want people to be able to access services we have to give them the means to do so.

For people to no longer have to beg there must be proper resources for homeless and drug treatment agencies and no situation where vulnerable people cannot access benefits. It is right that the public is encouraged to give to services, it is everybody's responsibility; however, public donations should be additional resources for agencies not what enables them to operate, this is the duty of government.

NHA calls for the issue of poverty and social exclusion to be central to this debate. Income support is very low, especially for young people and asylum seekers, who are expected to live on less than the rest of the population when life is clearly no cheaper for them. The coercive aspect of Job Seekers Allowance also means

that if anyone is not prepared or able to accept any offer of work they can be forced off benefits, while benefits can be sanctioned for a whole range of reasons, including being sacked. Research from the Joseph Rowntree Foundation shows that people often continue to beg because of benefit issues.

NHA members urge the public to join them in calling for significant improvements in the provision of drug and alcohol services and for the adequate statutory resourcing of all support services to vulnerable people.

Funding is the major problem local agencies face. They do not have the profile or resources to fundraise effectively. Homeless Direct is a groundbreaking new initiative that will allow the public to donate money or time to the local homelessness charity of their choice. Homeless Direct aims to use marketing techniques for social gain - to help local charities promote their work and understanding of the homelessness issues and encourage donations.

All the members of the Homeless Direct will benefit from the volunteering and "gifts in kind" elements of the "Change a Life" campaign, and the 50 first year Homeless Direct participating agencies will benefit from the fundraising element.

Homeless Direct is a truly revolutionary fundraising idea. No other charity has set up a system that allows the general public to give time or money to the charity of their choice within one sector. We anticipate that it will have a major impact for local charities and greatly strengthen the work they are carrying out.

NHA is the membership body for local organisations and individuals providing services and support to homeless people, which work with members to:

* influence policy at local and national levels;

* improve homelessness services and support;

* generate new funding for homelessness;

* improve public understanding and support for homelessness.

Major boost in brownfield development

Keywords Development, Environmental impact

Government plans to modernise the planning system to allow businesses to get planning permission quicker could result in an increase in the development of UK brownfield sites.

The reform proposals were highlighted at the CBI annual conference this week by Trade Secretary Stephen Byers.

The announcement comes hot-on-the-heels of a recent survey into land use in the UK by law firm Addleshaw Booth & Co and the environmental organisation Urban Mines, which revealed there is substantially more land available for re-development in the UK than previously thought.

Amanda Beresford, of Addleshaw Booth & Co., says:

The modernisation of the planning system, coupled with the amount of brownfield sites available for re-development in the UK and improvements in remediation technology could give the country a major economic boost.

Supported by technology, businesses today can locate themselves anywhere in the world, but Britain's existing regulatory regime may inhibit those wanting to invest in the UK. Bureaucratic delays can hamper many development and regeneration projects.

The survey has shown that brownfield land is available to meet developer's needs and that local authorities can regenerate their areas and limit unwanted pressure on green belt or sensitive areas.

The National Brownfield Sites Project involved teams of researchers carrying out detailed and comprehensive surveys of land use in eight towns and cities in England and Wales, carefully selected as a representative cross-section of communities around the country. Researchers deliberately targeted mixed-use areas rather than derelict ones and all land use in the designated areas was surveyed to produce a complete picture.

Local councils have traditionally assisted potential investors by identifying suitable redevelopment land but a shortage of resources often means they are unable to undertake the labour-intensive, detailed research carried out by the project team.

Although in some areas of the country, particularly the south-east where pressure for development is at its most intense, it is generally assumed that most available sites are known about, the survey still indicates there may be significantly more than previously thought. In Hounslow, for instance, researchers identified that there was 6 per cent brownfield land for potential development in the target area surveyed compared with the previously recognised figure of 0.6 per cent for the whole Hounslow area.

Detailed results of the two-year project will be published later this year and the findings explained at seminars to be held in Yorkshire and London.

Lack of industrial property pushes up rents

Keywords Industrial property, Rent

The industrial property market is in good shape but with a lack of supply in some areas rents are being pushed up to unprecedented high levels according to international property consultants King Sturge. The pound sterling has remained steady against the dollar for the past two years, despite its high value against the falling euro. Neither the currency realignment nor the high price of oil in the global marketplace has adversely affected the industrial property market.

Despite a recent increase, unemployment levels remain low as is inflation at 2 per cent or 3 per cent as measured by the retail price index. However, rents in many markets are growing at more than twice this rate. Angus McIntosh, King Sturge partner and head of research, sees changes in the global economy with the speed of growth of the *Internet* as having a marked effect in certain areas of property availability and rents. For example, where *Internet* Service Providers wishing to occupy Telehotel facilities are competing for space with traditional warehouse/industrial occupiers, a limited supply of suitable property is being stretched, forcing up rent levels.

In certain areas developers and investors are reluctant to build speculative development. However, in some markets modest levels of new supply are being created. In other areas demand and rental levels have not provided sufficient confidence for new construction.

Available industrial floorspace

In its latest report, "Industrial floorspace today", King Sturge note a steady market in industrial property in England and Wales with a decrease of just 1 per cent in the past four months in the total of industrial property available for sale or to let.

The new total of 11.436 million msup 2 shows a variation of less than 1 per cent over the last two years.

Regional variations are apparent in the survey with the south east, accounting for almost one-third of the English total, showing a reduction of 5 per cent in industrial property on the market and the south west showing a 6 per cent drop.

Conversely the West Midlands shows an increase of 6 per cent and East Midlands 10 per cent; East Anglia is up by 2 per cent and Wales by 1 per cent.

In the Northern regions, mixed figures show a 3 per cent increase in the north-west with decreases of 4 per cent in the north and 10 per cent in Yorkshire and Humberside.

Scotland continues its uplift with a rise of 11 per cent to 1,888 million msup 2 contributing 14 per cent of the British total.

The King Sturge Survey is conducted three times a year in April, August and December. The survey covers the total area of buildings on the market over 500 square metres in area but excludes properties marketed at or near site value, as well as semi-derelict property unsuitable for refurbishment. Details of the report and survey may be seen on www.kingsturge.com

CEED 2000 energy efficiency conference

Keywords Energy management, Efficiency

Energy efficiency schemes are us" was the very topical theme for the CEED 2000 Conference, organised this month at Aston Villa, Birmingham, by the Council for Energy Efficiency Development for the insulation industry.

Lord Whitty was due to deliver a keynote speech on behalf of the Government, but was called away on Government business. His talk was read by Conference Chairman, Phillip Ward, Director, Energy Environment and Waste, at the Department of the Environment, Transport and the Regions.

He discussed current and future expenditure on Government schemes. Some 70 per cent of the fuel-poor lived in private houses, the focus of the Home Energy Efficiency Scheme. With its funding of L600 million for the first four years, it would take 800,000 householders out of fuel poverty. The Energy Efficiency Standards of Performance Schemes - to be called Energy Efficiency Commitment - were being doubled to some L50 million a year between 2000 and 2002, when the scale would again be increased, requiring a trebling of the number of properties insulated. Around L2.5 billion was being provided to local authorities for housing investment in each of the next three years, with the aim of ensuring that all social housing is brought up to a decent standard by 2010, ending fuel poverty among social sector householders.

Lord Whitty "supported the effort of the Energy Efficiency Partnership's Insulation Strategy Group in producing a strategy to form the basis of a dialogue between industry, the energy suppliers, and local authorities to persuade them of the importance of insulation - and foster a stable and competitive insulation industry".

It was no coincidence that the schemes to which Lord Whitty referred were well discussed at the conference, being the most topical subjects within the energy efficiency industry. Because of this, and to promote the schemes, thus furthering Government interests, as well as supporting the energy efficiency industry, British Gas and the Eaga Partnership were the joint sponsors of CEED 2000.

Neil Marshall, Head of Social Policy, British Gas Trading, referred to the "need for effective collaboration between Government, energy suppliers and the energy efficiency industry". There would be a significant increase in the energy efficiency market for the EESoP Schemes, beginning April 2002, when it was visualised that some 950,000 cavity wall insulation and 1.2 million loft insulation installations would be undertaken, 1.3

million tank jackets fitted, 1.25 million condensing boilers installed, 63 million lightbulbs and 3.3 million appliances provided. Meanwhile they were spending L40 million on their current SoP Scheme, with L26 million going to the fuel-poor and disadvantaged customers.

Chris Leek, Director, Eaga Partnership, updated delegates on the Government Home Energy Efficiency Scheme, where they aimed to reach the 4.3 million households in fuel poverty. He described progress to date, explaining that "the new structure was set up and expanding, with referrals over target, but with plenty more still to do".

"Around half the carbon to be saved in 2010 in England and Wales was likely to come from existing dwellings, and around a fifth from new dwellings", according to another government spokesman - Ted King, Building Regulations Division, Department of the Environment, Transport and the Regions. He was discussing the Building Regulations Review currently being carried out in consultation with industry and others with interests in the energy performance of buildings, and the proposed changes to insulation standards both for new and existing buildings.

"If the proposals are implemented, better U-values for dwellings, that are dependent upon boiler performance, would be introduced in two stages. The improved standards for walls would be between 0.35 and 0.25 for dwellings with pitched roofs. Cold bridges would be discouraged. The three methods of calculation would include a switch from the SAP Energy Cost Method to one based on carbon emissions. The proposed changes to the definitions of work would create more roof, floor and wall insulation and draught proofing work in the existing stock of buildings. New dwellings were expected to be 25 per cent more energy efficient related to current practice, but would be between L600 to L1,400 more costly to build.

Don Lack, Leicester Energy Advice Centre, discussed the Home Energy Conservation Act (HECA) - investment in funding energy efficiency and how to make it pay.

Andrew Warren, Director of the Association for the Conservation of Energy - who led the lobbying which got the HECA through Parliament - spoke on progress with his current project, the Warm Homes Bill, to end fuel poverty by a set target date. The bill had completed its report and third reading stages in the House of Commons, had now moved to the Lords, and was expected to become law at the end of November: "Within a year of the bill becoming law, the Government must begin work on a strategy to end the scandal of fuel poverty in at least five million homes."

HECA Schemes also present opportunities for insulated render and cladding, the subject of a talk by Chris Buntain and Derek Childs, speaking on behalf of the Insulated Render and Cladding Association. This "tea-cosy" technology for higher insulation standards offered opportunities for new build, redundant buildings, for dealing with crumbling facades and cold, damp buildings, and for industrial and commercial buildings. As a refurbishment process, insulated render and cladding solved problems and upgraded the insulation, weatherproofing and improved the appearance, in social housing; it was useful in re-fenestration; and a cost-effective and technologically-sound solution to meet and exceed new thermal regulations, as a simple construction for new build projects. Stylish and unusual projects had even included an upside-down house - only in America!

The final speaker, Sue Lamb, Solarwall Ltd., urged Government, its agencies and fuel suppliers to harness the wealth of marketing expertise within the insulation installing industry to assist take-up within schemes, currently a problem in some areas. That installers wanted paying for this service was regarded as a downside by those responsible for schemes, whereas it should be seen as a very necessary expense to drive the schemes forward.

A lively discussion forum was chaired by Phillip Ward - and he was thanked by Jerry Robson, CEED Chairman, for his support. The conference ended with a tour of Aston Villa Football Club and an evening dinner for delegates.

Copies of speakers' slide presentations are available at L10 from the Council for Energy Efficiency Development, PO Box 12, Haslemere, Surrey GU27 3AH. Tel: 01428 654011; Fax: 01428 651401; e-mail: theceed@compuserve.com

Rural advocate to champion countryside

Keywords Rural areas, Legislation

Ewen Cameron, Chairman of the Countryside Agency, is to champion the needs of rural England at the heart of government in a new role as "rural advocate". The Deputy Prime Minister announced that Mr Cameron will have direct access to the Prime Minister and other ministers, and will join the Cabinet Committee of Ministers, which co-ordinates rural affairs. His role will be to tell ministers what the countryside needs from the Government, drawing on the Countryside Agency's own extensive research programme and practical experience.

Commenting on the Government's Rural White Paper published today, Mr Cameron said:

This Rural White Paper recognises the wider challenges facing those living in the countryside and the Government has shown it has been listening to rural people. This is a good start which now needs to be translated into action.

I want to see every government department test its policies against rural needs - does the policy work for or against, include or exclude, rural people and places? This so-called rural proofing will be a tougher test of the Government's commitment to the countryside than setting up a new rural department. It will mean there is no opt-out clause for any government activity. Rural concerns are no different from urban worries on health, jobs, services, transport, housing, education - but they need rural solutions.

The agency intends to keep the Government on track with delivering the White Paper and we will report annually on its progress. Mr Cameron said: "Ensuring a rural dimension in all policies will have a real impact on the people who live and work in the countryside. The test will be how swiftly Government can act on its recommendations. We will measure their success by reporting on progress to the Cabinet Committee and the Rural Sounding Board every year and by using our annual State of the Countryside report as a rural barometer."

Mr Cameron promised the Countryside Agency would play a central role in implementing the Rural White Paper, providing new transport solutions and helping local people take more control over local decisions.

He said:

I am delighted that we will be able to build on our successful transport schemes providing more and better ways of getting to work, shops and services. Transport is consistently cited as a major concern by rural people, and solutions are best found at a local level.

We will also help rural communities prepare their own town and village plans and train parish clerks to provide better local governance.

The Countryside Agency will also work closely with other partners to provide:

* "health checks" and tool kits to help regeneration of market towns;

* vital village services through a new Community Service Fund; and

* improving the quality of the countryside environment, especially around towns.

Further background statistics on the state of the countryside available from the Web site: www.countryside.gov.uk The Countryside Agency is responsible for advising Government and taking action on the social, economic and environmental well-being of the English countryside.

Property price report

Keywords Land registry, Property, Prices

The Land Registry published its quarterly residential property price report, covering the period July-September 2000, which compares average prices and volume of sales with those for the same period in 1999. It also gives a breakdown of the average sale prices of old and new properties, by property type (Table III).

The following information is contained in the report:

England and Wales

* The average price increased by 9.46 per cent from L97,616 in 1999, to L106,850 for the same period in 2000 (excluding sales under L10,000 and over L1m).

* All economic regions in England and Wales showed an increase in average prices.

* The volume of sales decreased by 6.89 per cent from 256,820 in 1999, to 239,114 for the same period in 2000.

Greater London

* The average property price increased by 14.14 per cent from L155,662 in 1999, to L177,665 for the same period in 2000 (excluding sales under L10,000 and over L1 m).

* The volume of sales decreased by 19.93 per cent from 39,409 in 1999, to 31,553 for the same period in 2000.

* In total, 335 properties over L1 million were sold.

As with the report from January-March 2000, sales of under L10,000 and over L1 million are now included. The Land Registry started collecting property price data in the first quarter of 1995. It holds no data prior to that date.

The Land Registry's Web site: www.landreg.gov.uk, contains a full copy of this new report and all previous reports. It also offers an *online* service, providing residential property prices and volumes of sales, broken down by property type, for the whole of England and Wales. Property price data are also available via our WAP service.

The sales included in the report relate to the transfer for full market value of the ownership of freehold or long leasehold properties, whether or not the purchase was supported by a mortgage. The price data are actual, unadjusted averages drawn from the great majority of all residential safes in England and Wales completed during the period.

This Land Registry report is intended to complement information available from other sources. If you make any comparison with other data you should consider the differences in volume, timeliness and coverage of contributing transactions.

The Land Registry's Property Information Centre also provides reports that show aggregated data for any local authority district in England and Wales, postcode area (e.g. GL), postcode district (e.g. GL1), or postcode sector (e.g. GL12). There is a fee for this service.

HM Land Registry is a government executive agency and trading fund responsible to the Lord Chancellor which keeps and maintains the Land Register for England and Wales. Its main purpose is to register title to land and to record dealings once the land is registered.

Internet property sites under scrutiny

Keywords *Internet*, Estate agents

A working party is to be set up to look at the possible regulation of *Internet* property sites. The move follows a call made at an Industry Forum, hosted by the National Association of Estate Agents (NAEA) and attended by delegates from some of the country's largest nationwide estate agents, independents and financial institutions.

NASA chief executive, Hugh Dunsmore-Hardy, said:

There are concerns over the credibility of some of the information on the sites and about site management.

The *Internet* has developed rapidly over the past few years, but there has been little or no regulation of the sites. Potential customers therefore have no means of assessing the reliability of the information provided, either about their own property, or about those they are looking to buy.

Customers, both buyers and sellers, should be able to know that they can rely on the accuracy of descriptions, that sites are regularly updated and that the sites are not simply a front to sell other services.

The working party will be made up of representatives from amongst the Industry Forum delegates and will be looking to establish whether it would be possible to create some sort of "approved" status or kite mark system which would give a guaranteed quality of service to all those using the site.

If it is possible to establish a system, we will also be considering which organisation would be best placed to run it.

The Industry Forum also heard Andrew Oswald, Professor of Economics at Warwick University, speak on the impact of stamp duty.

Delegates included: Graham Harris, president NASA; Bill McClintock, chairman of The Guild of Professional Estate Agents; Simon Agace, chairman, Winkworths; Paul Kinally, business development manager, Century 21; Michael Day, director IT, marketing and conveyancing, Connell; Michael Robson, chief executive, Andrews & Partners; Russell Galley, Halifax Estate Agencies; Philip Muzzlewhite, chairman TEAM; David Newnes, sales director, Your Move; David Maltby, managing director, Whitegates; Peter Mills partner, Humberts; Alan Gottschalk, area director, Bradford & Bingley; Robert Scarff, director, Western Region, Countrywide; Jim Atkins, Mike Jones, Julie Westby and John H. Smith, all NASA.

New Insolvency Act receives Royal Assent

Keywords Insolvency, Legislation

The UK Government's commitment to support viable businessess and encourage entrepreneurship was demonstrated when the Insolvency Act 2000 received Royal Assent.

The Insolvency Act will:

* give small companies in financial difficulty the option of a breathing space within which to put a rescue plan (a Company Voluntary Arrangement (CVA)) to their creditors;

* improve the efficiency and effectiveness of the procedure for the disqualification of unfit company directors.

The initial period of the CVA moratorium will be for 28 days. This period can be extended by up to a further two months.

The Insolvency Act 2000 makes other technical amendments to improve operation of the current provisions in the Insolvency Act 1986 and the Company Directors Disqualification Act 1986.

Competition and Consumer Affairs Minister, Dr Kim Howells, said:

I am delighted that this Act has received Royal Assent.

The new provision in the CVA procedure will help give more time to businesses experiencing short-term problems to agree a rescue proposal with their creditors.

This will stop creditors taking legal action against the assets of the company before it has had the chance to agree a solution to the problem with them.

On the speeding up of the procedure to disqualify company directors, Dr Howells added:

The power to disqualify unfit company directors is an important safeguard for consumers, to protect them and the rest of the marketplace against rogue directors.

Currently disqualification can only be achieved by means of legal proceedings and there are often delays in getting disqualification cases through the courts. The Insolvency Act 2000 provides that, where there is agreement, disqualification can be achieved administratively.

The procedure should now be more efficient and effective, ensuring that consumers and the business community are given earlier protection, in some cases at a reduced cost.

Implementation of the Act will take place when the necessary secondary legislation is ready next year.

Land Registry launches e-map project

Keywords Land Registry, *Internet*

The Lord Chancellor, Lord Irvine, has announced that the Land Registry is to launch an ambitious project to facilitate electronic access to its map data. Vectorisation of the Index Map represents the final phase in computerising over 45 million records and will provide customers with a graphical electronic gateway to all land data held by the agency.

The Land Registry Index Map records the location of some 18 million registered land parcels in England and Wales. Based on ordnance survey largescale maps, it is the only source of information which puts the Land Registry's registers of title in a geographical context. Held mainly in the form of some 400,000 paper map documents distributed throughout the Land Registry's 24 regional offices, it is currently updated manually.

The Lord Chancellor, in making this announcement, said:

I want to improve the quality, speed and accessibility of services to consumers and businesses. This includes taking the opportunities offered by new technology. Computerising the Index Map takes us along that route.

Peter Collis, Chief Land Registrar, welcomed the project, saying:

Computerisation of the Index Map ensures we remain on course to meet the Prime Minister's target for electronic delivery of government services by 2005. Additionally, with e-conveyancing on the horizon, we face possibly the most far reaching and exciting programme of land reform since the introduction of registration almost 150 years ago.

Computerisation of the Index Map will convert paper-held map information into electronic format and will require the digital capture of all registered land parcels for display over ordnance survey digital map data.

Lease pendulum swings tenants' way

Keywords Tenant, Lease

Tenants of commercial property are beginning to have a much bigger say over the terms and conditions of their occupational leases. And - with government encouragement - the days of onerously long-lease agreements with upward-- only rent review clauses look to be numbered.

Paul Rixon, landlord and tenant specialist, at BK - The Property Assets Consultancy, believes tenants facing lease renewals are now in a much stronger negotiating position, following structural changes in the property market over the past two decades.

"Tenants should be aware that lease renewal is an opportunity to negotiate terms that can differ radically from those that have applied to date and which reflect current market practice and sentiment", he explains. "In the 1960s and 1970s, institutional landlords insisted on 25-year lease terms in order to safeguard the income and therefore the capital value of their investments.

"But while many of these leases still haunt boardrooms up and down the country, 15 years is now the longest period landlords can now hope for - with the exception of new buildings in prime locations - and leases of five and ten years' duration are commonplace in today's market."

Break clauses abound in lease agreements nowadays, providing occupiers with the flexibility to react to changes - positive or otherwise - in their own businesses. Sometimes, landlords look for a premium rent in return for this reduced security, but Mr Rixon strongly advises tenants to avoid committing themselves to performance-related break options - only exercisable once a range of other lease obligations have been complied with. "Such options can be notoriously difficult to implement", he says.

An important legacy of the property recession of the early 1990s is the lease that allows for downward as well as upward rent reviews. The Government has recently indicated that it has not abandoned its negative stance towards upward-only reviews, but would prefer the property industry to provide a solution through self-regulation, rather than by legislative imposition.

In the meantime, tenants are reminded that, in nearly all circumstances, they are not obliged to quit their accommodation on the expiry of a lease and retain security of tenure until the terms of a new agreement have been established to the satisfaction of both parties. "The landlord", Mr Rixon insists, "cannot simply kick you out at the end of a lease.

"While a tenant is already in occupation of the property, a lease renewal is still a negotiation", he states. "The occupier should be considering the terms required well in advance of expiry, as landlords can commence proceedings up to 12 months ahead of that date.

"All the terms are open to negotiation at renewal", Mr Rixon adds, "not just the rent."

Greater flexibility in office leases

Keywords Landlord, Leases, Offices

Landlords should consider agreeing to provide the capital cost of major tenant alterations in return for an increase in rent, while corporate occupiers should think about agreeing to pay for the right to a break in a lease.

These are just some of the ideas outlined by law firm, Nabarro Nathanson, at the launch of its "Offices Initiative", which is aimed at bringing all of those involved in the design, construction, ownership, investment and occupation of commercial property. The initiative is bringing together a core team of specialist lawyers who have acted both for leading landlords and some of the most significant corporate occupiers in the offices market.

The aim is to develop, promote and implement innovative ideas and structures to realise the common interests of the office owner and the office user. The initiative challenges both landlords and tenants to work together and face the realities of the modern economy and new technologies.

Geoffrey Lander, founder and past President of the British Council of Offices and one of Nabarro Nathanson's most senior practitioners, explained why a new flexibility is required from both sides. He said that: "The old maxim of 'location, location, location' will be replaced by 'consultation, consultation, consultation', especially in relation to occupier needs, both before and after construction". He predicts the market will see developments like postoccupation audits, shorter lease periods, "tenants' manuals" and the introduction of rent reviews linked to the occupier's profits or turnover. He also predicts that the introduction of the new Accounting Standard's Board's recommendations, which will require occupiers to show leases on their balance-- sheets as either an asset or a liability, will result in widespread benchmarking of occupancy costs and that the occupier's quest for greater "corporate agility" will result in new, more flexible and imaginative leasing agreements.

His view was endorsed at the launch by Michael Griffiths, a director of Land Securities, who said: "We have for many years been extending our customer focus and believe we place a great emphasis on the importance of our customers and their requirements. Over the years, we have entered into many pre-let situations which have given us the opportunity to tailor our offer to meet client needs whilst ensuring we retain a commercial) acceptable building".

As the demand is growing for greater agility in leasing arrangements, Nabarro Nathanson is predicting that both investors and occupiers will want the certainty of easily ascertainable rental increases. It believes that this can be achieved in a variety of ways through fixed reviews, rents linked to profits or turnover, or index-linked rents. It predicts that these methods will increasingly replace the traditional five-year "upwards only" rent review.

The initiative is also suggesting a number of easy and practical steps in which the landlord-and-tenant divide can be bridged. For example, it is suggesting that landlords can provide tenants with greater flexibility by:

* re-energising rather than demolishing redundant buildings by investing in technology such as bluetooth (wireless technology which will help attract tenants back into such buildings);

* provide services which are meaningful, such as telecommunications connections in common parts, cash machines and a welcoming concierge.

Likewise, tenants are advised to offer greater flexibility in their dealings with landlords by:

* accepting a longer term lease in return for a fixed rent;

* agreeing to contribute to a sinking fund in return for the promise of a defined investment in the building-,

* releasing a landlord from liability automatically on a sale.

Ann Wright, the commercial property partner at Nabarro Nathanson, responsible for running the initiative, said: "There is a new realism in the corporate occupiers sector. Both landlords and occupiers are beginning to understand the commercial benefits both sides can realise from flexibility and a new 'enlightened self interest' with regards to lease agreements".

Landlords and corporate occupiers seeking information on the Offices Initiative should contact: Ann Wright at Nabarro Nathanson on: 020 7524 6000 or by e-mail at: a.wright@nabarro.com

New *Internet* research

Keywords Commercial property, *Internet*

Hartnell Taylor Cook, leading commercial property agents, unveiled research that shows that despite the current hype, the property world will not feel the full effects of the *Internet* revolution for several years to come.

The conclusion is based on a survey of over 200 leading commercial property agents carried out by Hartnell Taylor Cook over the last three months. The survey asked for agents' views on the impact of the *Internet* and the sector and questioned them about their thoughts for the future.

A total of 54 per cent of those questioned believed that it would be at least five years before commercial property transactions over the *Internet* became commonplace, with just 30 per cent of respondents currently offering commercial property marketing services, such as sales and purchasing, *online*. However, 59 per cent of those asked indicated that they would consider offering such services in the future.

The survey backed up the widespread belief that the retail and shopping centre markets will be most heavily affected by the *Internet*. Almost half of respondents believed that capital values would decrease as a consequence, while over one-third stated that both yields and vacancy rates would increase due to the growing influence of the *Internet*.

Martyn Guess, head of Hartnell Taylor Cook's London office, explained: "There is widespread agreement within the sector that the *Internet* will change the commercial property world but it is clear that there is still some way to go. Our findings demonstrate that the majority of property agents are keen to promote *online* services on company Websites but, so far, most are yet to commit the necessary budget and resources".

Health and safety legislation in 2001

Keywords Health and safety, Legislation

The coming year will see the biggest change in health and safety enforcement possible since the Health and Safety at Work Act 1974, and definitely since the "six-pack" regulations in 1992, warns Ciaron Dunne, writing in the latest issue of Facilities Management Legal Update.

To be forewarned is to be forearmed, and facilities managers should be planning ahead for the new legislation and, where possible, budgeting for the expense of compliance.

Expected major changes, reported in the January issue of Facititles Management Legal Update, include the following points.

(1) Penalties for health and safety offences will be increased, including raising the magistrate's maximum fine to 20,000 for most offences; making prison sentences available for most offences; and punishing culpable managers and directors with unpaid suspension and community service orders.

(2) New legislation is being considered by the HSE that would require employers to investigate accidents that are notifiable under the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations (RI)DOR) 1995. Facilities managers would have to exercise extreme caution not to admit liability in their accident reports - much as car drivers are advised by insurance companies never to admit liability for a road accident.

(3) There will be important and high-profile changes to the asbestos regulations, placing the responsibility for risk assessment and asbestos management firmly with the facilities manager. The Control of Asbestos at Work Regulations 2001 are expected in May 2001.

(4) The HSE will launch a major enforcement campaign in three areas of occupational health in 2001 - stress, workplace smoking, and vibration-- related injuries.

* The HSE is working on management standards to help managers deal with the problems of stress at work. These standards will place the onus on managers to undertake risk assessments to establish what the causes of stress might be, and how these causes can be dealt with. New guidance for employers is expected in spring 2001.

* The HSE has also decided upon an Approved Code of Practice to deal with passive smoking in the workplace. The code will require facilities managers to introduce a total or partial ban on smoking in the workplace and to make sure that building ventilation meets certain standards. Employers must be careful, however, when introducing a smoking policy, not to leave themselves open to claims of constructive dismissal from employees.

* HSE research in 2000 revealed that the health risks caused by vibration are greater than previously thought. New guidance on Hand-Arm Vibration Syndrome has already been published in 2001, and facilities managers would do well to review their procedures relating to power tools to avoid what will undoubtedly be a big area for compensation claims this year.

(5) Proposals for a new offence of Corporate Killing have received much coverage in both the FM and mainstream press. The proposals did not feature in the recently announced Safety Bill, but are expected to resurface during 2001. The new charge would make large employers much more at risk from prosecution and the commercial implications of having a corporate killing charge against your organisation's name should be enough to press most organisations into improving their procedures.

Ciaron Dunne, commenting on the forthcoming changes to heath and safety law, said: "The changes will undoubtedly have a significant effect on the management of the workplace and will make the role of the facilities manager even more important to the successful running of an organisation. Facilities managers should not expect their workload to get any lighter!".

Weatherall Green & Smith takes part in new property industry bible - Freeman's Guide to the Property Industry

Keywords Property evaluation, Property investment

Leading property industry valuation expert James Steevens, and director of research Keith Steventon, of Weatherall Green & Smith, have written the comprehensive 25-page valuation section of the latest property industry almanac Freeman's Guide to the Property Industry.

The valuation section - chapter two of the guide - brings together every aspect of valuation, providing answers to many questions posed when dealing with the complex issues of property investment.

James Steevens, who heads investment valuation for Weatherall Green & Smith, wrote the section to reflect the many facets of investment valuation and appraisals, including statutory requirements, guidelines, methods of valuation, accuracy and analysis.

James, who has over 25 years' experience in this field of the property industry, said: "Leading experts within the property industry were invited to take part and I was fortunate to be asked, along with Keith Steventon, to address the valuation chapter. It took me about three months to write the section because it needed to cover every aspect from a definition to rules and regulations. I have written a number of feature articles and taken part in writing for publications previously, particularly in my role as a Law Society approved expert witness; however, this has been perhaps the most prominent and I hope others will find it as useful."

Keith Steventon, director of Weatherall Green & Smith research, who also took part in producing the all-inclusive valuation chapter of the guide, provided valuable insight into forecasting, as well as broad-ranging research for the valuation and appraisals.

Keith commented: "Realistically speaking, no investment plan is coherent unless it includes sound forecasting. The Freeman's guide - and in particular the valuation chapter - is perhaps more far-reaching in that it provides a review of factors people in property investment should be taking account of. In fact, the entire guide will give a step up in gaining insight into many aspects of the property investment market."

The guide - whose first edition was published in June of this year - has been described as having something for everyone with an interest in the property industry. Andrew Goldstone, managing editor, added: "Since we launched the first edition we have received a tremendous response from all sectors of the industry. What people tell me they like is the combination of expert essays on, say, valuation or planning, next to detailed profiles of property companies, major retailers and surveyors. I know it's a cliche but there really is something for everyone and that's why it's doing so well. We have already sold several thousand copies, with new orders coming in every day from all sorts of companies, both here and abroad. I'm sure Freeman's new interactive on-line service will be just as well received, especially as it offers news, extra entries, continuous updating and search functionality. All along our aim has been to provide a cost-effective and easily accessible source of information that everyone in property can use. The market seems to be saying we've achieved it, which makes the last 18 months' hard work worthwhile. Our aim now is to grow both the printed and on-line service without compromising our high standards."

The guide is available from Freeman Publishing plc (0207 462 0870, E-mail: sales@freemanpublishing.co.uk) at a cost of L195 per edition. The on-line/book combination package costs L395.

Two new reports available from The Stationery Office

Keywords Reports, Urban environment

Two new Department of Transport, Environment and the Regions Reports are now available from The Stationery Office (TSO).

Our Towns & Cities: The Future - Delivering an Urban Renaissance. The first White Paper on urban affairs for more than 20 years, sets out the Government's policies on urban areas. The Paper details Government action on improving the urban environment, developing a thriving economy and delivering good services.

The plan aims to put people first - encouraging them to remain in and move back to towns and cities through a variety of key measures in taxation, crime, the environment, health and housing.

Major social changes have been taken into account: people are living longer, having fewer children and many more are living alone. Up to 3.8 million extra households will need to be accommodated by 2021.

The 105 recommendations of the Urban Task Force are also included, showing how the Government has responded and how each has been taken forward.

Our Towns & Cities: The Future - Delivering an Urban Renaissance, ISBN 0 10 149112 3, costs, L28 from TSO. The Governments response to the paper (ISBN 0 10 149122 0) is also available at a cost of L6.95.

The second report, Climate Change: The UK Programme, was launched by the Deputy Prime Minister at The Hague. The document sets out the UK's programme for delivering its promise to reduce greenhouse gas emissions and move beyond its targets under the Kyoto Protocol. It also begins to consider and set in motion the changes the UK will need to make to reduce emissions in the longer term and adapt to the possible impact of greenhouse gases already in the atmosphere.

Climate Change: The UK Programme, ISBN 0 10 149132 8, costs L25 from TSO.

Orders for the above publications can be placed by telephoning 0845 7023 474 or on-line on www.thestationeryoffice.co.uk and quoting the relevant ISBN number.

Surveying the twenty-first century

Keywords Technology, Surveys

Malcolm Hollis' Surveying Buildings has been the definitive surveying reference for nearly a quarter century. Professor Hollis has kept practitioners and students informed of the latest changes in technology and market conditions while emphasising the traditional skills of building inspection and forensic diagnosis handed down from surveyor to surveyor over the centuries.

This new, fourth edition is the first for almost a decade. It has been completely rewritten and updated by Professor Hollis in order to explain the new challenges facing surveying professionals at the dawn of the twenty-first century.

The fourth edition of Surveying Buildings offers over 70 per cent more text than the previous edition - and thus reflects the increasing complexity of surveying practice today. Professor Hollis discusses the unprecedented range of opportunities and responsibilities facing today's practitioners - in particular those offered by digital technology, new software and the *Internet* - and he analyses the effect on the property and construction industries of radical shifts in underlying economic conditions. Judge Charles Gibson, a leading expert on property and construction law, analyses the impact of current legislation from both the UK and Europe. He points out ways in which older property falls short of modern legislation and suggests alterations that must be carried out to meet those requirements. He also offers practical advice concerning both liability and breach of duty.

This new edition also offers 65 per cent more illustrations than the previous edition. Most of the photographs have been taken personally by Malcolm Hollis in order to illuminate specific technical insights, facts and figures. Surveying Buildings offers numerous other practical aids, including detailed checklists and tables.

Above all, Professor Hollis reminds students and practitioners that the most important tools possessed by a surveyor are his or her senses and analytical skills. Drawing on his own experience of thousands of real-life surveys, from the UK to the Middle East, he provides detailed and practical guidelines for conducting thorough surveys and reducing the risk of errors. He helps surveyors prepare for building inspection, know what to look for, interpret correctly what they see, and write an accurate report that meets the needs of the client.

Surveying Buildings will continue to be indispensable to surveying professionals well into the twenty-first century - as practitioners continue to seek to balance the opportunities presented by the latest technology with traditional skills and standards established over hundreds of years.

The impact of technology on surveying

In the new edition of his definitive surveying reference, Surveying Buildings, Professor Malcolm Hollis examines the impact of technology on surveying while reminding surveyors that their own minds and bodies remain the most sophisticated technology of all.

The use of video equipment and cameras (both film and digital) for photographing a property is increasing. The advantage of external elevations being photographed at the time of the survey is that one has a record of the evidence that was available at the time of the survey. This is often a useful weapon in defending a surveyor when a claim is made.

The digital camera has improved the surveyor's ability to see around corners. By pushing the camera into the gaps. or outside windows, pictures can be taken of dormer roofs, flashings and slate finishes where previously they were concealed. The rear view panel on the camera enables a check to be made during the inspection, as well as a record of the image to be included within the report.

Other, more complex equipment, available includes infra-red thermography, to locate deficiencies in cavity-wall insulation, and impulse radar to locate fissures within walls three metres thick.

It is only through the use and interpretation of the information provided by one's senses that one can decide which piece of equipment to get out and point at the property, to either verify or discount one's theories or what further tests should be carried out before a commitment to purchase the building is made. The value of surveyors is their ability to understand the information that the equipment produces and their ability to interpret the data and advise upon its relevance. The machines available at the moment only deal with specific areas of the property and individual components. It is hoped that the future will see a balanced partnership between the brain and the machine.

Surveying Buildings is published by RICS Books.

Better buildings for industry

Keywords Energy management, Buidings

There is the potential to reduce energy consumption in industrial buildings by up to 50 per cent. The most efficient and cost-effective way of achieving that reduction is to build in energy efficiency at the design stage.

The UK Government's Energy Efficiency Best Practice programme is running a series of free workshops during the first quarter of 2001, which will equip building purchasers, occupiers, designers and contractors to work more effectively together to design energy-efficient buildings for industry.

The "Better buildings for industry" events are aimed at purchasers, designers and occupiers of industrial buildings - the first wave of these are, not surprisingly, already fully booked! As a result of the unprecedented demand, additional events are now being planned.

The "Selling better buildings to industry" workshops are specifically for contractors supplying energy-efficient buildings and buildings services to industry - places are limited so early booking is strongly recommended.

Both series of events are based around two newly-published Good Practice Guides; GPG 304, "The purchaser's guide to energy-efficient buildings for industry" and GPG 303 "The designer's guide to energy-efficient buildings for industry".

GPG 304 is designed to assist in the specification and purchase of energyefficient buildings for industry through encouraging an integrated approach to the building fabric and building services and by providing a checklist of energy efficiency options. The appraisal procedure for these options will show where it is cost-effective to improve energy efficiency above the minimum required by the Building Regulations.

The Guide provides purchasers with a systematic approach to be used with designers and contractors to quickly evolve cost-effective, energy-efficient designs. The Guide will help purchasers in the development of a brief for designers and provides a list of questions to ensure that all the energy efficiency options have been considered and properly appraised. This appraisal process includes reference to the Climate Change Levy and Enhanced Capital Allowances.

GPG 303 will assist designers in working effectively with their clients to produce energy-efficient buildings through encouraging an integrated approach to the building fabric and building services and by providing a checklist of energy efficiency options. The guidance provided is intended to ensure that energy efficiency is included at the earliest stage of the project brief and that it is fully considered at every stage of the design. It provides the design team and client with energy efficiency options and the consequences of their selection.

The benefits associated with using the Guides include:

* quicker decision-making processes during the design stage arising from better understanding between clients and designers;

* better understanding of the benefits of energy efficiency, resulting in improved briefing of designers;

* communication of the benefits of energy efficiency to the client;

* greater client satisfaction through matching building design to business needs while improving comfort for occupants;

* reduced environmental impact over the lifetime of the building;

* lower operating costs for the building owner;

* enhanced rent or resale value;

* minimising the impact of the Climate Change Levy;

* maximising the benefits of Enhanced Capital Allowances.

For further information about the workshops and how to obtain copies of the Good Practice Guides mentioned, call the Environment and Energy Helpline on Freephone 0800 585794, or visit the Web site at: www.energy-efficiency.gov.uk

Britain's cleanest city

Keywords Competition, Cleaning, Awards

The announcement of the finalists in the "Britain's Cleanest City 2001" contest means that ten out of the UK's 58 cities are now a step nearer capturing the coveted title. Each of them has done particularly well to beat off stiff opposition from a record number of entrants and marked improvements in all-round standards to achieve their place on the shortlist of the competition, which is sponsored by the British Cleaning Council, the co-ordinating body for the country's L12 billion cleaning industry.

Now going forward to the stage of the competition are six of the finalists from the 1999 competition, the last occasion the biennial event was held: current title-holder, Chester, which has vowed to become the first city in the history of the competition to retain the trophy, as well as last year's three runners-up, Bath, Peterborough and Westminster, plus Hull and Manchester. Three cities achieving shortlist success with their first-ever bid for the title are Lincoln, Ely and the City of London, while Plymouth is straight back into the shortlist after entering again for the first time since taking the title back in 1991.

From this list will emerge the eventual winner of the increasingly prestigious title, announced at a special award ceremony on 6 March 2001, the opening day of The Cleaning Show, the British Cleaning & Support Services international exhibition at the NEC in Birmingham.

The aim of the competition, the seventh since the BCC launched the award scheme in 1988, is threefold:

(1) to identify the city which presents itself in its general environs and public buildings as the UK's Cleanest City;

(2) to encourage and recognise efforts to raise cleanliness standards throughout Britain's cities; and

(3) to create an awareness of the need for continual improvement of the enviroment.

Entry requirements have been streamlined this year, placing less emphasis on written submissions and photographs supplied by cities, and more weight on what judges actually see when they pay their unannounced visit to each entering city. All that was asked for from entrants was a brief submission indicating how the city goes about its cleaning, along with details of innovative ideas, public education and awareness campaigns, partnerships with business or community groups and any other relevant initiatives introduced over the past 12 months.

Taking the tourist's eye view

This was followed by a personal on-the-spot assessment of every participating city by the judges, who surveyed city-centre streets, parks and gardens, shopping centres and public buildings - inside and out - to see just how clean and litter-free they really were. Taking the tourist's eye view, they targeted for particular scrutiny the places which are likely to have the greatest impact on visitors: tourist attractions, including local museums, cathedral precincts and tourist information centres; bus and railway stations; approach roads, car parks and park-and-ride ter-mini; and, of course, public toilets.

Now that they have their "top ten", the judges will be making their second round of inspections in order to determine the eventual winner; these further visits, along with the written submissions, will also help them in making their selection for the special Chairman's Awards, designed to reward initiative and excellence in key areas, where cities have demonstrated and implemented particularly creative schemes to promote manicipal cleanliness.

Differences between finalists and non-finalists often only "marginal"

"The record number of entries this year along with a continued rise in standards has given the judges some difficult decisions to make in selecting the shortlist", declared Peter Bird, immediate past BCC chairman and chairman of the "Britain's Cleanest City" competition judging panel. The difference between those cities which came just within the top ten and those that fell just outside was very marginal. Without exception, every city that entered has made marked improvements in maintaining municipal cleanliness, with major investments in such areas as extending paved areas, upgrading cleaning regimens, provision of filter and gum bins, and a whole plethora of "partnerships" with traders and the community. Educational initiatives aimed at stopping people dropping litter have almost become the norm.

Nevertheless, say the judges, cities sometimes fail to make the grade, not because of any deficiency in their cleaning teams or routines but through a lack of consideration from the general public, who continue to drop litter, even just after a cleaning machine has passed by. "There is still a great need to instil a culture of 'clean breeds clean'", added Peter Bird.

"This will be a very tough competition to judge, with finalists extending from the very biggest cities, like Manchester, to the very smallest, such as Ely, as well as those faced with especially mammoth tasks like the neighbouring Cities of London and Westminster", commented Andrew Herman, current BCC chairman. But the range and size of this year's entry is a welcome sign: it means that more and more cities are becoming aware of the importance - to both their residents and their visitors, and thus, to their economy - of achieving the highest possible cleanliness standards. Prizes such as ours, prestigious though they are, are just the icing on the cake".

Floods and global warming are key issues

Keywords Property markets, Surveys

Surveyors advising potential purchasers and investors in residential property will welcome the exciting and spectacular new annual trade show, The Property Business Show, that will focus on hot issues in the market and looks destined to become the single biggest 13213 event in the residential property industry calendar.

The Property Business Show is the first event of its kind designed to appeal to everyone connected with the residential property sector, from surveyors, solicitors and mortgage brokers to developers, housebuilders and professional landlords and from estate agents to letting agents and property management companies.

This new flagship trade event takes place on 22-23 February, alongside its bigger brother at one of the country's best-known and most prestigious exhibition venues - the Grand Hall at London's Olympia. The Evening Standard Homebuyer Show will run concurrently with the event.

The show is the brainchild of Nick Clark, head of Homebuyer Events, who also runs the Evening Standard Homebuyer Show, together with the New Homes and Property section of the BBC Good Homes Show, at the NEC.

"This event meets a very clear need within the industry", he says. "Surveyors specialising in the residential property arena have never before had to interface with such a vast array of new products, services and technologies. There is an enormous amount to absorb. Now, at long last, there's going to be a major annual event to bring all this together under one roof."

The primary aim of the two-day event will be to introduce all those working within the residential property sector to the very latest specialised products and services available, through the medium of a major trade show. Exhibitors expected to take part will include everyone from lenders, insurance companies, printers and property

media companies to advertising and PR agencies, manufacturers of promotional goods and franchisors; computer hardware manufacturers. *Internet* companies and specialised software houses to office equipment suppliers, shop-fitters and signmakers.

A major programme of seminars is planned to run in conjunction with the exhibition - a programme that offers delegates a unique opportunity to learn, be entertained and motivated by some of the very top speakers from the world of international real estate, specially flown into London for this one event.

Strictly closed to the general public, entry to the event will be free to pre-registered delegates who will enjoy the added benefit of free access to the adjoining Homebuyer Show and its 100 plus exhibitors.

Says Nick Clark: "Building on the proven success of the Evening Standard Homebuyer Show, we are confident that the Property Business Show will soon be firmly established as the absolute 'must-attend' event of the property year."

Further details are available from: Homebuyer Events Ltd, Mantle House, Broomhill Road, London SW18 4JQ. Tel: 020 8877 3636; Fax: 020 8877 1557; E-mail: info@propertybusinessshow.com
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Evidentiary Exhibit 60

The Regulatory News Service

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Delancey Estates PLC 21 December 2000

DELANCEY ESTATES PLC

Interim Results for the period ended 30 September 2000

Delancey Estates creates shareholder value through astute commercial property investment, enhanced by prudent gearing, and corporate acquisitions

HIGHLIGHTS

* Increase in value of net assets to #279m (March 2000: #269m)

* Adjusted net asset value per share up 2.4% to 139.5p (March 2000: 136.2p)

* Profit before tax up 58% year on year to #3.9m (September 1999: #2.5m)

* Gross property income increased to #26.0m in the period, 300% up year on year (1999: #6.6m)

* Earnings per share (fully diluted) up 35% to 1.4p (1999: 1.04p)

John Manser, Chairman of Delancey Estates, comments:

"Over the past six months, the Group has concentrated on progressing the stated strategies set out in June. These consist of reducing and ultimately withdrawing from all direct provincial holdings; increasing the direct investment into Central London and commencing the investment programme for Mapeley."

21 December 2000

ENQUIRIES:

Delancey Estates plc Tel: 020 7486 6663 Jamie Ritblat, Managing Director Graham Emmett, Finance Director College Hill Tel: 020 7457 2020 Gareth David Email: gareth.david@collegehill.com Lisa Pearson Email: lisa.pearson@collegehill.com

DELANCEY ESTATES PLC

Interim Results for the period ended 30 September 2000

CHAIRMAN'S STATEMENT

These results reflect the considerable progress which the Group has made during this period in letting its development portfolio and the progress it has achieved towards its strategic objectives, as set out in June. They consist of reducing and ultimately withdrawing from all direct provincial holdings; increasing the direct investment into Central London and commencing the investment programme for Mapeley.

Contracted or agreed sales post September 2000 within the Provincial Portfolio currently amount to more than #170m, while the London Portfolio has, since March 2000, been augmented by the acquisitions of three new properties for a total consideration of #33m (including post September 2000 acquisitions).

In respect of Mapeley, of which the Group owns 15%, success has been reflected through the acquisition of the entire Abbey National plc real estate portfolio and an agreement to acquire the real estate assets of HM Customs & Excise and the Inland Revenue, together with the associated services contract.

Results and Summary

6 months 6 months ended 30 Restated
ended September 1999
year ended
30 September
2000 31 March
2000 * Adjusted net asset
value per share 139.5p 115.8p 136.2p
* Rental and fee income #26.0m #6.6m #25.3m
* Valuation uplift #11.5m N/A #54.8m
* Profits before tax #3.9m #2.5m #9.3m
* Gearing 1.4x 0.2x 1.4x
* Cost of debt 7.2% 6.8% 7.3%
* Fair value of
-#1.7m +#3.4m +#2.3m
financial liabilities
The interim results include full consolidation of the consultancy business (CCRE) and as a comparative the year ended March 2000 has been restated.
For the first time, we undertook an interim valuation of the property portfolio. The net positive movement of the portfolio was #11.5m (5.3p per share), broken down as #9.2m for the investment portfolio and #2.3m for the trading portfolio.
Gross Property Income in the period increased to #26.0m, up 300% year on year (#6.6m) and 3% up on the March year end. This reflects the contribution of the property portfolio of Milner Group Properties Limited, acquired in October 1999, and the completion of two of our retail developments.
DELANCEY ESTATES PLC
Interim Results for the period ended 30 September 2000
CHAIRMAN'S STATEMENT (cont'd)
Administrative expenses in the property business were #4.5m. These reflect the initial costs of the additional staff resulting from the Milner acquisition, the professional fees incurred as a direct result of the level of portfolio management, sales activity and the #1.2m amortisation of goodwill associated with the CCRE, Centros Miller and Freehold Portfolios Estates.
Profit before tax increased to #3.97m (#2.51m), representing a 58% increase year on year. After a provision for tax of #0.9m, the Group's profit after taxation amounted to #3.1m (#1.8m). In line with the Board's policy of focussing on asset growth as the main measure of performance and shareholder value, the Board is of the view that no interim dividend should be paid.
Investment Portfolio Review
In the period since April 2000, we have increased the London Portfolio with the following acquisitions:
* One third interest in Rolls & Arnold Houses, Fetter Lane, EC1 (offices)
* Quay House, Millennium Quarter, Docklands, E1 (offices)
* 41-42 Portman Square, London W1 (offices) (post September 2000)
Significant disposals included:
* 117 Piccadilly, London W1 (offices)
* Michael House, Chiswell Street, London EC2 (offices)
* Berkeley Street, London W1 (offices)

Principal lettings within the London Portfolio were achieved at the following rental levels (all figures relate to rent per square foot and to Zone A in the case of retail lettings):
* #55.00, #57.50 and #67.50 (post September 2000) at 130 Jermyn Street,
London SW1
* #50.00 and #52.00 at 40 Portman Square, London W1
* From #85.00 (31/03/00) to #93.00 (post September 2000) at Stop and Shop,
Clapham Junction
* From #120.00 (31/03/00) to #126.00 (post September 2000) at Victoria
Place, Victoria Station
* From #100.00 (31/03/00) to #120.00 (post September) at Islington, London
N1
DELANCEY ESTATES PLC
Interim Results for the period ended 30 September 2000
CHAIRMAN'S STATEMENT (cont'd)
Significant disposals in the Provincial Portfolio included:
* Eastern Avenue Retail Park, Gloucester (retail warehouse)
* City West One, Leeds (offices) (post September 2000)
* Jacksons Square, Bishop's Stortford (shopping centre) (post September
2000)
Total sales for the first half amounted to #36m, producing a profit above March 2000 valuations of #1.7m. Income attributable to these properties was # 1.8m, reflecting an average sales yield of 5% net of costs. Since the period post 30 September, further sales have been agreed or contracted amounting to # 170m. Income attributable to these properties is #13.3m, reflecting an average sales yield of 7.5% net of costs.
For accounting purposes, the Group recognises sales on completion and acquisitions on exchange.
Voids within the Group's investment and trading portfolios are currently running at 1% and with negligible arrears.
Developments
Projects under construction now only consist of:
* Manchester Square, London W1, fully leased to ICI plc
* The Glasshouse, Glasgow, 69% leased (58% leased as at March 2000)
* Islington, London N1, 64% leased (58% leased as at March 2000)
* Millennium Plaza, Cardiff, 52% leased (75% leased as at March 2000)
In Cardiff, our fitness operator, Healthland, has been placed in administration. However, negotiations are ongoing to replace them and we hope to sign a new tenant in the near future.
The income attributable to the developments on an annualised basis is estimated to be #9.1m of which #6.4m is already contracted. The value of these developments on a completed basis is #131m. The costs expended to date of #61m are reflected in the balance sheet with #54m remaining to be spent. The uplift in value at practical completion, as reflected in our adjusted Net Asset Value statement, will be #16m.
DELANCEY ESTATES PLC
Interim Results for the period ended 30 September 2000
CHAIRMAN'S STATEMENT (cont'd)
Valuations
The portfolio movements since March 2000 were as follows:
% London City + 5.7

West End + 5.3
Mid-Town + 7.0
Shopping Centres + 2.0
Provincial Shopping Centres - 2.9
Offices + 1.0
Retail Warehousing nil
Leisure - 2.2
Group Income
Since March, the Group's annualised income, including pre-let developments, has risen to #46.2m. As at September, 53% of our income was derived from the London Portfolio and 47% from non-London assets. Assuming agreed sales proceed, these figures would be adjusted to 70% and 30% respectively.
Equity Investments
The Group's investments in CCRE and Centros Miller at September amounted to # 27m and #3.4m respectively. Our commitment to Mapeley includes a #22.5m requirement for new projects within this financial year, of which #12.5m has been invested since September.
Partnerships/Management
We currently have interests in three limited partnerships, six joint ventures, three equity investments and four management contracts, two of which have performance related profit shares.
Our most recent limited partnership was formed with Clerical Medical Investment Group to acquire Rolls & Arnold Houses, EC1. Under the terms of this partnership, the Group receives fee income and an enhanced profit share similar to the terms negotiated on the acquisition of 151 Buckingham Palace Road, SW1.
Current annual fee income generated from all these ventures was #0.4m for the six months and #1.0m on an annualised basis.
DELANCEY ESTATES PLC
Interim Results for the period ended 30 September 2000
CHAIRMAN'S STATEMENT (cont'd)
Milner Acquisition
We have just reached the anniversary of our acquisition of Milner Estates. We have virtually completed and fully leased all the development properties and either sold, agreed to sell or are marketing the non-core assets. We have rescheduled most of the banking and rationalised the staffing. We are making a profitable return on our investment.
We are currently re-organising CCRE. During the past six months, we merged the two businesses of Conrad Ritblat and Colliers Erdman Lewis, which are now practising as Colliers Conrad Ritblat Erdman (now known as CCRE). We are making a further announcement later today regarding the future of this business.
Internet-related Investments
We hold a 47.5% equity stake in spacetorent. This is now establishing itself as the leading national *internet* property rental portal, utilising the low costs of the *internet* for distribution, whilst retaining an underlying 'bricks and mortar' business to provide, primarily in the residential market but also in the commercial, student and holiday sectors.
The *internet* site www.spacetorent.com was established in September and now has some 5,000 properties available for letting which are owned by approximately 2,000 landlords. spacetomanage, a division of spacetorent, is now managing over 800 residential properties and we are expecting this to grow substantially.
The listed market for e-commerce and tech stocks has become illiquid over the last six months and, therefore, it has not been propitious to seek a separate listing for spacetorent. We will be reviewing this matter over the

coming months. As a result we are not now reflecting any uplift in value at September, compared with #2.75m at March.

We have taken a number of other small initiatives since September, which are progressing well. One of these was an investment in F-Prop.com, which has reversed into AIM listed Hansom Group Plc, for a nominal cost. Our holding in Hansom Group Plc is 1.7m shares, worth #272,000 at the current mid price of 16p.

DELANCEY ESTATES PLC

Interim Results for the period ended 30 September 2000

CHAIRMAN'S STATEMENT (cont'd)

Employees

Due to a restructuring of the property management and accounting departments, post the Milner acquisition, staffing levels have reduced from 40 to 28 during the course of the past six months. We have welcomed new senior management in the accounts team and, since September, have boosted our Central London team with the appointment of Stafford Lancaster, a Partner responsible for running the Investment department of Healey & Baker's City office.

Financing

We currently enjoy the benefit of committed banking facilities totalling #606m (#544m March 2000). Of this amount, #515m (#440m March 2000) is drawn down, and includes #87m of the #120m Milner Estates acquisition facility from the Royal Bank of Scotland (RBS).

Of the additional #91m of committed facilities, #54m will be utilised during the course of the year to fund the completion of the developments at Islington, Millennium Plaza Cardiff, Glasgow and Manchester Square. The remaining #37m is available for new acquisitions on a short term revolving basis.

On the first anniversary of the Milner acquisition the RBS loan facility has a net balance of #56m outstanding, as #31m of cash is on deposit awaiting financial assistance clearance under section 156 of the Companies Act. We anticipate repaying this facility in full by February 2001, 14 months after it was originally drawn.

Our average cost of debt remained static at 7.23% p.a. (7.26%) despite a reduction of medium term interest rates by 0.5%. This is a direct result of our interest rate hedging policy. Of the #569m of available facilities (#515m drawn plus development commitments of #54m), 75% or (#428m) is hedged until the maturity. The remainder of the unhedged loans is the Milner/RBS acquisition facility.

As most of our hedging is held outside of the property owning company we are able to switch the hedging products around the portfolio as assets are sold. Therefore, as we continue to sell assets in the second half, we are running a less than 100% hedged loan book.

The reduction in medium term interest rates has also reduced our FRS13 adjustment from an asset of #2.3m in March 2000 to a liability of #1.7m at the half year.

The average term of our loan facilities has reduced from 88 months in March to 76 months at the interim, a result of our asset disposal programme in the first half, and the use of a short term facility to purchase Rolls & Arnold House. The average gross loan to asset value achieved is 78% and net of deposits 70%. In terms of shareholder gearing this equates to a gross gearing of 1.8x and net gearing of 1.4x.

DELANCEY ESTATES PLC

Interim Results for the period ended 30 September 2000

CHAIRMAN'S STATEMENT (cont'd)

Outlook

We remain conscious of the discount to our assets of our share price and are considering renewing powers to re-purchase up to 10% of our share capital. We will not, however, pursue any options unless we feel very

confident that shareholders will benefit. Following the completion of the refocusing set out in June, and with new initiatives in train, the Group is well placed for further profitable growth.

JOHN MANSER CBE, DL

Chairman

21 December 2000

DELANCEY ESTATES PLC

Interim Results for the period ended 30 September 2000

Consolidated Profit & Loss Account

Unaudited Unaudited Audited

six months six months year

ended ended ended

30 30 31 March

September September

2000 1999 2000

(Restated)

Note #'000 #'000 #'000

Turnover 2 45,999 6,562 45,221 Less : share of joint ventures turnover (4,266) (123) (382) Turnover - group 41,733 6,439 44,839 Operating expenses (1,140) (563) (1,834) Net income 40,593 5,876 43,005 Profit on sale of stock properties 1,769 886 1,362 Administrative expenses (23,645) (2,529) (25,469) Group Operating Profit 18,717 4,233 18,898

Share of operating profit/(loss) in

joint ventures 34 (437) (370)

Total Operating Profit : group and 18,751 3,796 18,528

share of joint ventures

(Loss)/profit on sale of investment (86) (172) 5,538 properties Profit on sale of investments 775 2,530 2,558 Net interest payable and similar charges

Group (17,059) (3,643) (17,114)

Joint ventures (127) - (233)

Profit on sale of swaption 1,715 - -

(15,471) (3,643) (17,347)

Profit on Ordinary Activities before 3,969 2,511 9,277 Taxation Taxation

Group (909) (727) (1,713)

Joint ventures 3 - 95

Profit on Ordinary Activities after 3,063 1,784 7,659 Taxation Minority interest 17 - (93) Profit for the financial period 3,080 1,784 7,566 Dividends - (76) (2,227) Retained Profit for the Financial Period 3,080 1,708 5,339 Earnings Per Share Basic 3 1.42p 1.10p 4.00p Diluted 3 1.40p 1.04p 3.96p

DELANCEY ESTATES PLC

Interim Results for the period ended 30 September 2000

Statement of Group Total Recognised Gains and Losses

Unaudited Unaudited Audited

six six year

months months

ended Ended ended

30 30 31 March

September September
2000 1999 2000
(Restated)
#'000 #'000 #'000
Profit for the financial period after taxation 3,080 1,784 7,566 before dividends
Unrealised surplus on revaluation of investment properties
Group 8,590 - 26,854 Joint ventures - - 985
Unrealised (deficit)/surplus on revaluation of investments
Group (2,775) - 2,775
Tax on realised surplus on revaluation of investment properties (286) - -
Tax on realised surplus on revaluation of 21 (1,210) (1,408) investments Total recognised gains relating to the period 8,630 574 36,772
DELANCEY ESTATES PLC
Interim Results for the period ended 30 September 2000
Consolidated Balance Sheet
Unaudited Unaudited Audited
as at 30 as at 30 as at 31
September September March
2000 1999 2000
(Restated)
Notes #'000 #'000 #'000
Fixed Assets
Intangible assets 27,890 7,825 25,587 Tangible assets 7,770 412 8,248 Investment properties 511,372 241,560 483,092 Investment in joint ventures: Share of gross assets 20,170 6,592 16,686 Share of gross liabilities (14,023) (8,340) (10,940)
6,147 (1,748) 5,746 Other investments 7,738 5,671 18,112
560,917 253,720 540,785
Current Assets
Stock 124,884 19,403 133,300 Debtors 61,527 18,721 31,809 Investments 3,341 - 7,392 Cash at bank and in hand 94,169 86,202 73,910
283,921 124,326 246,411
Creditors: amounts falling due within one 4 (181,869) (52,083) (68,394) year Net Current Assets 102,052 72,243 178,017
Total Assets less Current 662,969 325,963 718,802 Liabilities
Creditors: amounts falling due after more than one year (374,420) (126,398) (439,636) Provisions for liabilities and (9,785) (695) (9,718) charges Net Assets 278,764 198,870 269,448
Capital and Reserves
Called up share capital 54,148 44,843 54,148 Share premium account 144,576 117,459 144,576 Contingent equity share 1,771 2,054 1,771 capital Warrant proceeds 10,663 10,663 10,663 Revaluation reserve 40,192 6,811 36,514 Other reserves 5,550 5,550 5,550 Profit and loss account 20,786 11,490 15,834
Total equity shareholders' 6 277,686 198,870 269,056 funds
Equity minority interests 1,078 - 392
278,764 198,870 269,448
DELANCEY ESTATES PLC

Interim Results for the period ended 30 September 2000
Consolidated Cash Flow Statement
Unaudited Unaudited Audited
six six year
months months
ended ended ended
30 30 31 March
September September
2000 1999 2000
(Restated)
Note #'000 #'000 #'000
Net Cash Inflow from Operating Activities 7 1,711 52,720 52,171 Returns on Investments and Servicing of Finance Interest received 1,691 2,085 5,101 Interest paid (17,944) (1,949) (15,697) Issue costs of new bank loans (1,736) (2,086) (4,719) Profit on sale of swaption 1,715 - -
(16,274) (1,950) (15,315)
Taxation Corporation tax paid (1,731) - (4,124)
Capital Expenditure and Financial Investment Purchase of investment properties (39,001) (123,755) (177,912) Purchase of fixed asset investments (15) (5,670) (7,219) Purchase of other investments - - (6,877) Provision of trade loans (29,343) (2,751) (8,498) Purchase of tangible fixed assets (26) (146) (514) Sale of investments 4,853 19,445 19,470 Sale of investment properties 26,881 1,825 65,019 Sale of tangible fixed assets 6 26 303
(36,645) (111,026) (116,228)
Acquisitions Purchase of subsidiary undertakings - - (135,919) Net cash acquired with subsidiary - - 9,634 undertakings Purchase of interests in joint ventures - (1,970) (2,513)
- (1,970) (128,798) Equity Dividends Paid to Shareholders (2,099) (1,603) (1,606)
Management of Liquid Resources (Increase)/decrease in short term money 8/9 (25,629) (23,104) 1,171 market deposits
Net Cash Outflow before Financing (80,667) (86,933) (212,729)
Financing Issue of ordinary share capital - 29,000 29,024 Expenses of share issue - (551) (2,100) New loans 95,404 79,938 267,272 Repayment of loans (24,127) (22,368) (70,397)
71,277 86,019 223,799 (Decrease)/increase in cash in the period 8/9 (9,390) (914) 11,070
DELANCEY ESTATES PLC
Interim Results for the period ended 30 September 2000
Notes to the Interim Report
1.Financial Information and Basis of Preparation
The Accounting Standards Board (ASB) has issued a non-mandatory statement "Interim Reports", which seeks to codify best practice in the presentation of interim results. This report, which incorporates a revaluation of investment properties as at 30 September 2000, has been prepared having regard to the guidance in the ASB statement and on the basis of the accounting policies set out in the group's audited financial statements for the year ended 31 March 2000.
The interim financial information is unaudited and does not comprise full financial statements within the meaning of S240 of the Companies Act 1985. The figures for the year ended 31 March 2000 are an extract from the full financial statements for that year which have been delivered to the Registrar of Companies and on which the auditors issued an unqualified audit report which did not contain a statement under S237(2) or S237(3) of the Companies Act 1985.

The figures for the year ended 31 March 2000 have been restated to include Milner Consultancies, with fair values attributed to the individual assets and liabilities as at the date of acquisition, and corresponding adjustments to goodwill. Goodwill is amortised through the profit and loss account over the period the directors consider to be its economic useful life, estimated at 20 years for Milner Consultancies and 10 years for other acquired companies. Milner Consultancies had previously not been consolidated on the grounds that it was intended to dispose of the subsidiary within 12 months from acquisition. However, the group's controlling interest in this subsidiary will not now be disposed due to changes in circumstances since 31 March 2000.

DELANCEY ESTATES PLC

Interim Results for the period ended 30 September 2000

Notes to the Interim Report (cont'd)

2.Segmental Analysis

Unaudited six months Audited year ended

ended

30 September 2000 31 March 2000

Property Property Property Property

investment consultancy investment consultancy Total

Total (Restated) (Restated) (Restated)

#'000 #'000 #'000 #'000 #'000 #'000 Turnover

Rental activities

Group 21,350 - 21,350 23,175 - 23,175

Joint 4,266 - 4,266 382 - 382

ventures

Property management

Group 408 - 408 1,720 - 1,720

Gross property 26,024 - 26,024 25,277 - 25,277 income Property - 19,975 19,975 - 19,944 19,944 consultancy Total turnover 26,024 19,975 45,999 25,277 19,944 45,221 Profit on ordinary activities before taxation Net income 20,618 19,975 40,593 23,061 19,944 43,005 Profit on sale of stock properties 1,769 - 1,769 1,362 - 1,362 Administrative (4,541) (19,104) (23,645) (7,378) (18,091) (25,469) expenses Share of operating profit/(loss) in 34 - 34 (370) - (370) joint ventures

Total operating 17,880 871 18,751 16,675 1,853 18,528 profit (Loss)/profit on sale of investment (86) - (86) 5,538 - 5,538 properties Profit on sale of 775 - 775 2,558 - 2,558 investments Net interest payable

Group (16,999) (60) (17,059) (17,102) (12) (17,114)

Joint

ventures (127) - (127) (233) - (233)

Profit on 1,715 - 1,715 - - -

sale of

swaption

Profit on ordinary activities before taxation 3,158 811 3,969 7,436 1,841 9,277

DELANCEY ESTATES PLC

Interim Results for the period ended 30 September 2000

Notes to the Interim Report (cont'd)

3. Earnings per share

Basic earnings per share has been calculated on the earnings attributable to ordinary shareholders of #3.1 million (interim 1999: #1.8 million : full year 2000: #7.6 million) and the weighted number of ordinary shares in issue during the period of 216.6 million (interim 1999: 162.3 million, full year 2000: 188.7 million).
Diluted earnings per share has been based on a weighted number of ordinary shares in issue of 218.5 million (interim 1999: 170.5 million : full year 2000: 190.8 million) which assumes conversion of all dilutive potential ordinary shares.
4. Creditors: amounts falling due within one year
Unaudited Unaudited Audited
as at as at as at
30 September 30 September 31 March
2000 1999 2000
(Restated)
#'000 #'000 #'000
Loans 139,243 5,793 1,703 Overdrafts 4,020 - - Trade creditors 3,944 1,113 3,223 Other creditors 8,652 198 5,805 Corporation tax 3,633 4,308 3,518 Other taxes and social security 2,272 120 2,571 Accruals and deferred income 14,840 15,188 25,600 Dividends - 2 2,153 Deferred purchase consideration 5,265 25,361 23,821 181,869 52,083 68,394
DELANCEY ESTATES PLC
Interim Results for the period ended 30 September 2000
Notes to the Interim Report (cont'd)
5. Financial Assets and Liabilities
The following table provides a comparison by category of the carrying amounts and the fair values of the group's financial assets and liabilities. Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties, other than a forced or liquidation sale and excludes accrued interest. Where available, market values have been used to determine fair values. Where market rates are not available, fair values have been calculated by discounting expected cash flows at prevailing interest rates.
Fair value Book value
as at as at
30 30 Value
September September
2000 2000 adjustment
#'000 #'000 #'000
Primary financial instruments held or issued to finance the group's operations
Borrowings (521,485) (520,937) (548) Short term deposits 87,553 87,553 - Cash at bank and in hand 6,616 6,616 -
(427,316) (426,768) (548)
Derivative financial instruments held to manage interest rate profile
Interest rate swaps (556) - (556) Interest rate caps 1,320 724 596 Interest rate swaptions 1,220 2,433 (1,213) (425,332) (423,611) (1,721) After tax at 30% (1,205)
DELANCEY ESTATES PLC
Interim Results for the period ended 30 September 2000
Notes to the Interim Report (cont'd)
6.Reconciliation of Group Shareholders' Funds

Unaudited Unaudited Audited
six months six months year
ended ended ended
30 30 31 March
September September
2000 1999 2000
(Restated)
#'000 #'000 #'000
Opening shareholders' funds (restated) 269,056 169,180 169,180 Retained profit for the financial period 3,080 1,708 5,339 Other recognised gains and losses relating to 5,815 - 30,614 the period New share capital issued (including share - 30,197 68,148 premium) Contingent share capital - (478) (761) Warrant proceeds - 44 44 Issue costs - (571) (2,100) Other reserves (265) (1,210) (1,408) Closing shareholders' funds 277,686 198,870 269,056
7.Reconciliation of Operating Profit to Net Cash Flow from Operating
Activities
Unaudited Unaudited Audited
six months six months year
ended ended ended
30 30 31 March
September September
2000 1999 2000
(Restated)
#'000 #'000 #'000 Continuing operating activities
Operating profit 18,717 4,233 18,898 Depreciation and amortisation 1,668 480 1,997 Profit/(loss) on disposal of tangible fixed 68 - (101) assets Decrease in debtors 1,074 4,418 8,133 (Decrease)/increase in creditors (24,691) 34,812 4,411 Decrease in stock 4,875 8,777 18,833 Net cash inflow from continuing operating 1,711 52,720 52,171 activities
DELANCEY ESTATES PLC
Interim Results for the period ended 30 September 2000
Notes to the Interim Report (cont'd)
8.Reconciliation of Net Cash Flow to Movement in Net Debt
Unaudited Unaudited Audited
six months six months year
ended ended ended
30 30 31 March
September September
2000 1999 2000
(Restated)
#'000 #'000 #'000
(Decrease)/increase in cash in the period (9,390) (914) 11,070 Cash used to increase/(decrease) liquid 25,629 23,104 (1,171) resources
16,239 22,190 9,899 Cash inflow from increase in net debt (71,277) (56,850) (191,823) Change in net debt resulting from cash flows (55,038) (34,660) (181,924) Change in net debt arising from acquisition - - (171,929)

Change in net debt resulting from non-cash (972) - (1,339) flows Net debt brought forward (366,521) (11,329) (11,329) Net debt carried forward (422,531) (45,989) (366,521)

9. Analysis of Net Debt

At At

1 April Cash Non-cash 30 September

2000 flow flow 2000

(Restated)

#'000 #'000 #'000 #'000 Cash at bank/(overdraft) and in hand 11,986 (9,390) - 2,596 Money market deposits 61,924 25,629 - 87,553 Debts due within one year (1,703) (137,540) - (139,243) Debts due after one year (438,728) 66,263 (972) (373,437)

(366,521) (55,038) (972) (422,531)

DELANCEY ESTATES PLC

Interim Results for the period ended 30 September 2000

Notes to the Interim Report (cont'd)

10. Adjusted Net Asset Value Per Share

Unaudited Audited

as at as at

30 31 March

September

2000 2000

Pence (Restated) Pence

per per

#'000 share #'000 share

Shareholders' funds per Balance Sheet 278,764 128.7 269,448 124.4

Add: Unrecognised gains Valuation surplus on development 15,890 7.4 16,995 7.8 properties Valuation surplus on trading properties 12,361 5.7 10,031 4.6

Net asset value attributable to ordinary 307,015 141.8 296,474 136.8 shares

FRS 13 (liability)/asset (1,721) (0.8) 2,306 1.1 Tax at 30% on trading properties and FRS 13 (liability)/asset (3,192) (1.5) (3,701) (1.7)

Adjusted net asset value attributable to ordinary shares 302,102 139.5 295,079 136.2 Diluted adjusted net asset value attributable to ordinary shares 133.9 131.0

All gains on investment properties are stated before tax. If they were all realised at the period end, the additional tax payable, at 30%, would be # 12.9m (6.0 pence per share).

11. Capital Commitments

As at 30 September 2000, the group had commitments under development funding agreements totalling #54.0 million (31 March 2000: #33.8 million).

12. General

The interim accounts for the six months ended 30 September 2000 were approved by the board on 21 December 2000.

This report is being sent to all shareholders. Copies are also available at the company's registered office and at 40 Portman Square, London, W1H 0AA.

ISIN-NO: GB0000517630

LOAD-DATE: December 22, 2000

Evidentiary Exhibit Number 61

PR Newswire

November 15, 2000, Wednesday

SECTION: FINANCIAL NEWS

DISTRIBUTION: TO REAL ESTATE AND BUSINESS EDITORS

LENGTH: 1509 words

HEADLINE: Homestore.com, Inc. and The National Association of Realtors(R) Unveil eREALTOR.com(SM) -The Next Phase of The Realtors(R) Electronic Transaction Platform;

Online Suite of Tools Helps Agents and Brokers Manage the Real Estate Transaction and Connect With Trading Partners

DATELINE: THOUSAND OAKS, Calif., Nov. 15

BODY:

Homestore.com, Inc. (Nasdaq: HOMS) and the National Association of Realtors(R) (NAR) unveiled eREALTOR.com(SM) -- the first phase of the Realtors(R) Electronic Transaction Platform, announced at the NAR Mid-Year Convention in May. eREALTOR.com(SM) -- an innovative *online* system designed to facilitate and streamline the steps involved in managing the purchase or sale of a home -- is a collaboration among industry leaders which include Homestore.com and its subsidiaries, TOP PRODUCER(R) and WyldFyre(TM); its joint venture REFormsNet, the National Association of Realtors(R); GMAC Real Estate and GMAC Mortgage; Fannie Mae; the California Association of Realtors(R); and, as recently announced, Cendant Corporation and its CENTURY 21(R), COLDWELL BANKER(R), and ERA(R) real estate brands.

The eREALTOR.com(SM) transaction platform, demonstrated during the NAR 2000 Realtors(R) Conference & Expo last week, enables real estate professionals to leverage the power of the *Internet* to help customers move from pre-contract through home closing, making it more efficient for all parties involved. eREALTOR.com provides, among other things, an automated scheduling and workflow engine, an order center linked to real estate brokers' key trading partners -- including title and escrow service providers, mortgage brokers, and inspection companies -- and an electronic document storage and transaction archive.

"We committed in May to work with industry powerhouses to build the most effective real estate transaction platform available *online* today," stated Stuart Wolff, chairman and chief executive officer of Homestore.com, Inc. "eREALTOR.com, with best of breed products from superstars in the real estate, financial and technology sectors, will truly streamline and revolutionize the home buying process for both consumers and professionals in the year to come."

eREALTOR.com(SM) uniquely integrates the key applications used by real estate professionals during the Real Estate Activity Lifecycle (REAL), including:

Lead Generation: eREALTOR.com(SM) links to Realtor.com(R), the official site of the National Association of Realtors(R), and the most popular real estate site in the U.S. with more than 3 million unique users each month and over 130,000 professional subscribers. Consumers searching for properties on Realtor.com(R) can initiate a transaction folder and securely provide their real estate professional with their preferences, contact information and other personal data.

Contact Management and Sales Support: eREALTOR.com(SM) incorporates top products of TOP PRODUCER -- the 1 CRM and marketing software in the industry with more than 100,000 customers. Customer records are automatically linked for sharing with the eREALTOR.com(SM) platform.

Property Listings Management: eREALTOR.com(SM) interfaces with WyldFyre Listings -- the 1 MLS access software with more than 100,000 customers in more than 100 key MLS markets. Real estate professionals can transfer property records from their MLS to the eREALTOR.com(SM) platform.
Contracts and Disclosure Management: eREALTOR.com(SM) taps ZipForm(R) -- the 1 electronic contracts software, with more than 75,000 customers and almost 10,000 pages of standardized settlement forms sorted market-by-market. eREALTOR.com(SM) extracts from the electronic contracts key dates, disclosure data and other information that drives the closing process.
Cendant has announced plans to support the platform for its CENTURY 21(R), COLDWELL BANKER(R), and ERA(R) national franchises, as part of a definitive agreement signed by Homestore.com to acquire Cendant's real estate portal move.com. With GMAC Real Estate's, Prudential Real Estate's and RE/MAX International's support of the platform in May, all six of the largest U.S. national franchise organizations are behind Homestore.com's industry standard for *online* real estate transactions.
"This system is created by real estate professionals for real estate professionals, and we were pleased to demonstrate where we are to-date with our members at the annual NAR convention," said Dennis Cronk, president of NAR. "Our goal is to keep the real estate professional front and center of the transaction, to accelerate the home buying process, eliminate duplicate efforts, increase consumer satisfaction and build strong customer relationships that reinforce the value of Realtor(R) services. With eREALTOR.com, we have all scored a home run."
eREALTOR.com(SM) also improves the consumer experience during the closing process by providing each buyer and seller with a private Web site and tools to track each step of their transaction, determine if it is on-time, and communicate with their agent or broker to provide feedback and order services electronically. The consumer interface can be integrated seamlessly with brokers' or franchises' regional and national Web sites.
In the first quarter of next year, eREALTOR.com(SM) will be customized for brokers and national real estate franchisers to enable them to tailor the system to match their business and local market requirements. "With a single point of entry, integration between all components, seamless flows of contact, property and consumer information, and customized flexibility and adjustability by market, category and broker, this is a win for the entire industry," stated Steve Ozonian, president of Realtor.com(R), during NAR convention proceedings.

About Homestore.com, Inc.

Homestore.com, Inc. (Nasdaq: HOMS) is the leading network of sites on the *Internet* for home and real estate-related information, products and services. Homestore.com, Inc.'s family of Web sites includes the Homestore.com(TM), Realtor.com(R), HomeBuilder.com(TM), SpringStreet.com(TM) and HomeFair.com(TM) Web sites. Consumers can view over 1.4 million new and existing homes for sale and find broker and agent services on Realtor.com(R), the official *Internet* site of the National Association of Realtors(R). Consumers searching for new homes can find more than 130,000 models, new homes and built-to-suit plans on HomeBuilder.com(TM), the official new homes site of the National Association of Home Builders. Consumers interested in renting an apartment will find listing information from more than 45,000 properties in more than 6,000 cities on SpringStreet.com(TM). Homestore.com's(TM) remodeling area covers home improvement needs for both consumers and remodeling professionals. Comprehensive moving and relocation information on the *Internet* is available from HomeFair.com(TM). Other subsidiaries of Homestore.com, Inc. include WyldFyre Technologies, the leading developer of software used to access Multiple Listing Service data and property photos; TOP PRODUCER, North America's 1- selling provider of leads management and marketing software for real estate professionals; and THG, the leading provider of technology-driven solutions and services to the relocation industry. THG will be integrated into a new unit called Homestore.com Mobility Technologies, Inc.

Homestore.com(TM) also has content distribution relationships with America *Online*; Excite @Home, Netscape and Go Network/Infoseek.

About the National Association of Realtors(R)
The National Association of Realtors(R), "The Voice for Real Estate," is America's largest trade association, representing more than 760,000 members involved in all aspects of the residential and commercial real estate industries. Realtors(R) is a federally registered trademark used to identify members of the National Association of Realtors(R).

This press release contains forward-looking information within the meaning of Section 27A of the Securities Exchange Act of 1933 and Section 21E of the Securities Exchange Act of 1934, and is subject to the safe harbors created by those sections. Actual results, including but not limited to usage of the Homestore.com sites, may differ materially. The matters discussed in this press release also involve risks and uncertainties described from time to time in Homestore.com, Inc.'s filings with the Securities and Exchange Commission (SEC). In particular, see "Risk Factors" in the Final Prospectus included in the Company's Registration Statement on Form S-1 declared effective by the SEC on January 26, 2000 and also see the Company's Annual Report on Form 10-K for the year ended December 31, 1999 filed with the SEC (http://www.sec.gov). We assume no duty to update this information in this press release if any forward-looking statement later turns out to be inaccurate.

SOURCE Homestore.com, Inc.
CONTACT: press, Karen Fulton of Homestore.com, Inc., 805-557-2661, karen.fulton@homestore.com; or Steven Cook of National Association of Realtors, 202-383-1014, scook@realtors.org; or financial, DeLise Keim of Homestore.com, Inc., 805-557-2599, delise.keim@homestore.com
URL: http://www.prnewswire.com
LOAD-DATE: November 16, 2000

Evidentiary Exhibit Number 62

AAP Company News

November 1, 2000, Wednesday

SECTION: Part 2 of 3

LENGTH: 1256 words

HEADLINE: Commitments Test Entity - First Quarter Report

DATELINE: Sydney

BODY:

HOMEX - Perth

Commitments Test Entity - First Quarter Report

STRATEGIC INITIATIVE BY KEY BUSINESS AREA

AUSSIE.COM.AU

aussie.com.au is Australia's leading on-line business directory. Established in 1995, it was among the first directories of its kind in Australia.

Today aussie.com.au indexes approximately 1.3 million Australian businesses and is receiving around 3,500,000 hits per month.

OUR UNIQUE SELLING PROPOSITION

aussie.com.au's has three distinct competitive advantages over other business directories:

1. Every Australian business can remotely add or update its contact details via the Web, making businesses in control of their own data.
2. This control reduces the cost of data maintenance and assures the end-user of the most accurate and up-to-date information.
3. A company's free listing on aussie.com.au includes far more comprehensive information than other directories including company name, address, phone and fax numbers, mobile phone numbers, toll free numbers, contact names and links to email and web addresses. These basic contact details are free - however revenue is derived from Australian businesses paying for additional categories, profile pages, or to upgrade their listing to gain prominence in their business category.

MAJOR MEDIA SUPPORT

A highly targeted launch strategy was test marketed in Western Australia utilising television, radio, press, telemarketing and direct mail. The launch strategy has been evaluated and refined for each market to capitalise on the strengths of different media. Billboard was used in the Victorian launch to great success. Email marketing has been extraordinarily successful in targeting businesses to add or upgrade their listings. *Online* marketing now plays a significant role in the development of the business through email

marketing, banners on sites including excite and ninemsn and affiliate programmes including flowershop.com.au and CDNOW.
January 2000 aussie.com.au launched a major promotional campaign in Western Australia.
* June 2000 our Victorian operation was launched with a significant media campaign, including billboard and email marketing resulting in website traffic increasing to around 3.5 million hits per month.
* October 2000 the Queensland operation was launched.
* October 2000 major national consumer marketing campaign launched.
* Sydney launch is planned for later this year.
With the opening of each state, marketing spend has been reduced, revenues improve and market share is expanded. Additionally website traffic is expected to exponentially exceed current numbers.
MAJOR ACHIEVEMENTS
* Website traffic has grown from 350,000 in November 1999 to around 3.5 million hits in June 2000.
* Currently, 28% of small-medium sized businesses nationally are aware of the aussie.com.au *internet* site.
* As at April 2000, 42.7% of households sampled are aware of aussie.com.au. This is a massive increase from December 1999 when the figure was just 5.2%.
* Victorian operation launched in June 2000.
* Queensland operation launched in October 2000.
*'Windowshopping' e-commerce facilities launched nationally on aussie.com.au.
* A unique and highly recognisable consumer marketing campaign launched October 2000 in Western Australia, Victoria and Queensland.
COMMERCE AUSTRALIA
Commerce Australia's suite of portals, including realty*online*.com.au and rentfind.com.au are leveraging off the national expansion of aussie.com.au to create a suite of full service sites to capture the growing *online* real estate market.
Commerce Australia is in discussion with several eastern states software and real estate organisations to leverage sales opportunities in those markets.
REALTY*ONLINE*.COM.AU
realty*online*.com.au allows real estate agents to upload sales listings and automate administration functions including client contracts, expense management and database.
realty*online*.com.au's proprietary software and strategic alliances with banks, mortgage and Insurance originators, creates a strong sales opportunity. Revenue is derived from the provision of the software.
RENTFIND.COM.AU

rentfind.com.au provides *online* access to maintenance providers and simple control tools for the financial management of rental properties.

COMMERCE AUSTRALIA IS ALSO AN *INTERNET* SERVICE PROVIDER (ISP)

Commerce Australia's ISP creates further sales opportunities for the aussie.com.au business, enabling it to utilise its existing sales and marketing infrastructure to market Commerce Australia products including its ISP and suite of real estate portals.

INFORMATION ABOUT SHAREHOLDERS AND INVESTORS

Aussie *Online* Limited has 326,184,365 shares on issue and is dual listed on the Australian and Frankfurt Stock Exchanges.

European investment companies are major shareholders of Aussie *Online* Ltd, further extending support in the European market.

A POSITIVE FUTURE FOR AUSSIE *ONLINE* LIMITED

Aussie *Online* Limited has an exciting future developing Australia's leading on-line business directory and its real estate solutions.

Significantly increased revenue flows are anticipated from the opening of our Victorian, Brisbane and New South Wales operations and the launch of a fully integrated consumer marketing campaign.

We continue to evaluate new technology solutions to add value to the aussie.com.au website. Businesses now have access to full e-commerce capabilities from their directory listing on aussie.com.au.

Our short to medium term plan is to assess WAP and SMS facilities, form strategic alliances with suitable partners, reduce media spending once acceptable awareness levels have been reached Australia-wide and above all, increase shareholder value.

Aussie *Online* Limited is has developed its aussie.com.au site and database to create a complementary suite of vertically integrated portals including innovative e-commerce development - each providing opportunities for new revenue generation.

The integration of the two businesses, maximises the synergies between Commerce Australia's suite of portals providing software and *internet* solutions to the real estate and rental market and Aussie *Online* Limited's existing national business directory, aussie.com.au.

OTHER EVENTS

The company has appointed a State Sales Manager in New South Wales and plans to open offices there by the end of November 2000.

Online marketing has commenced with ninemsn and excite. Affiliate programmes are in place creating further revenue opportunities.

Discussions with potential major partners continue. The outcome of discussions in September with AAPT will be finalised in the latter part of this year.

The site has been geocoded to link WAP and CDMA applications to the aussie.com.au site.

Numerous co-branding opportunities have been implemented to broaden the reach of the aussie.com.au site and increase traffic.
Alliances with marketing partners including America *Online*, AAPT and BankWest, have significantly reduced media spend and targeted business customers and consumers.
Significant savings and improved revenues are beginning to be realised as a result of the increased use of on line marketing initiatives including permission based marketing and affiliate programmes.
LOAD-DATE: November 1, 2000

Evidentiary Exhibit Number 63

Chicago Sun-Times

September 15, 2000, FRIDAY, Late Sports Final Edition

SECTION: HOMELIFE; Pg. 1; N

LENGTH: 1461 words

HEADLINE: Choices galore ;

New types of realty agents let home sellers and buyers pick only the services they need

BYLINE: HELEN MARSHALL

BODY:

Buyer's agents. One-stop-shopping services. Fee-for-service agents. Niche agents. Whew!

The brave new world of real estate today offers more choices to both seller and buyer, but the basic question remains the same as it was a decade ago when the options were to sell it yourself or have an agent do it for you:

How much do you know about handling the biggest financial transaction of your life?

What's changed today is that sellers now can decide on how much help they need and pay for it accordingly. Deep discount brokers argue they can save sellers thousands of dollars with what essentially is an enhanced FSBO (for sale by owner). Traditional agents argue that nothing can match the personal service, experience and advice they offer.

The other major change? The *Internet*. The National Association of Realtors reports 37 percent of home buyers use the *Internet* as an information source.

At the full-service-plus end of the spectrum is the agent working on commission and offering one-stop shopping for such services as insurance, mortgage approval and referrals for legal advice, often at no additional cost. (All commissions are negotiable, but the prevailing figure is about 6 percent of the selling price split between agents for the buyer and the seller.)

"One stop shopping services have emerged as a driving consideration in buying and selling a home," said Richard A. Smith, CEO of Cendant Corporation's Real Estate Division. Encompassing the Coldwell Banker, ERA and Century 21 companies, it is the nation's largest residential real estate organization. Cendant started focusing on the all-inclusive concept in the mid-'90s.

"It's a big time saver for homeowners, particularly for people who are out of town," said Chris Eigel, president of Wilmette-based Koenig & Strey/GMAC Real Estate. His company works with Platinum Home Services, which acts as a general contractor arranging for painting, repairs, cleaning and decorating for clients in need of some fix-up.

At the other end of the spectrum is the agent or company whose service is just one step above an FSBO. Example: Econobroker (www.econobroker.com).

For a $ 495 flat fee, you get a for-sale sign, Web site exposure, photography and a property listing on the Multiple Listing Service of Northern Illinois, an all-important computer catalog of available properties.

Clients have to price the home themselves, show it and negotiate the final deal.

"Typically our clients know what the price is going to be, and then anything else outside of that we suggest that they use their attorney -- which ends up being less expensive than using a Realtor and actually better information," said Tom Condon, Econobroker founder and chairman.

Econobroker targets FSBOs and basically is selling exposure to the MLS. Who is his company not for? Condon said: "Someone who wants a lot of hand-holding and who wants someone to talk them through the process step by step. We don't provide any of the quasi-psychological services that Realtors do."

His clients pay a commission -- usually 2 1/2 to 3 percent -- to the buyer's agent if the buyer has one. What they save on is not having to pay commission to a seller's agent.

A similar service is offered by Homebytes.com (www.homebytes.com), whose basic $ 499 package also includes a market analysis and toll-free telephone support.

Tip: When an agent offers to advertise your home "on the *Internet*," ask how many people will be viewing your listing.

Between the two extremes you have the limited service and fee-for-service agent.

"I don't think most people are comfortable with just punching it in (to the MLS) and then being left on their own," said Chris Jacobs, owner of Colonial Realtors Inc. in Inverness. His company charges $ 595 plus 3 percent at closing with a half percent going to Colonial and 2 1/2 percent to the buyer's agent.

Jacobs said he offers the services of a traditional agent, including an MLS listing, with one exception -- Colonial does not host open houses.

Sellers can pick and choose what they need with a fee-for-service firm, such as Help-U-Sell (www.helpusell.net). "We're trying to unbundle the menu of services," said the company's president, Rick O'Neil.

The company charges a flat fee with no commission. Area offices are in Grayslake and Lake Villa. Services and fees vary from franchise to franchise. A sales help package costs about $ 3,200. A listing in the MLS is extra. You show the home yourself.

"If we're sitting open houses, we can't be doing other things, and we're basically giving our time away," said Marty Golden of Help-U-Sell in Grayslake.

Clients who need help only in negotiating the deal can buy Golden's skills "unbundled" for about $ 1,000.

Found across the entire real estate spectrum is the "*online* agent." In real estate, not having some *Internet* business presence today is like not having a telephone. What varies is how much of the interaction between agent and client is *Internet*- and e-mail-based.

ZipRealty.com is making waves, describing itself as a full-service brokerage with a created-for-the-Web sales model. Salaried teams of field agents work face to face with clients out of mobile offices in blue VW Beetles called "zipMobiles." They share responsibility for clients with the company's *online* agents. Clients and agents are in contact via *online* chat, e-mail, fax and phone.

Sellers using zipRealty pay a 1.5 percent commission to zipRealty, plus a 3 percent commission to the buyer's agent, for a total of 4.5 percent. Buyers using

zipRealty get back half of the 3 percent commission that zipRealty got from the seller (up to $ 15,000), payable at closing.

The company entered the Chicago area market at the end of July, registering 100 active clients in two weeks.

ZipRealty is not targeting FSBOs, said company President Scott Kucirek. "We believe there's a huge segment of the people that's pretty smart, professionals. They know what they want. What we're saying is let's provide them with the support staff necessary to provide the information buyers and sellers need," he said.

Sellers get a Web page with a 360-degree tour of their home, as well as placement in the MLS. ZipRealty's buyers get automatic e-mail notification of new listings that meet their specifications, as well as access to a comprehensive, detailed database of local listings.

The company also does a market analysis and shows the home.

Elsewhere on the *online* scale is the traditional agent using the Web and e-mail to save time and effort for both agent and client.

JoAnn Sworan with Prudential Preferred Properties' Chicago Gold Coast office is the first agent in the Chicago area to receive the National Association of Realtors' ePro designation.

"I have an office, but I rarely meet my clients at an office anymore," she noted. Sworan said *online* communication allows her to provide clients with enough information so they can buy property the first time they're out for a real drive-by.

The niche agent is an expert on a focused area of real estate or segment of the buying and selling population.

Jerry Fisch, owner of A Community Real Estate Service, has been selling property in the Hyde Park-Kenwood area for 17 years. "It's knowing the history of the property and how the property has been developed or the stages of renovation the house has been through," he stated. Fisch said such expertise is especially valuable to the condo buyer who wants to know the history, strengths and weaknesses of a condo association.

One way to find a specialist agent is through a local Chamber of Commerce or the Chicago Association of Realtors.

Also on the list: The buyer's agent. Illinois state law changed in 1995 to allow agents to represent a buyer. Before the change, agents were presumed to work for the seller.

This arrangement normally comes at no cost to the buyer. Good advice in any agent-client relationship: Always ask what if anything the agent's services are costing you.

"The buyer's broker isn't just interested in selling their listings. The buyer's broker is going to spend a lot of time listening to what the buyer wants to buy," Fisch said. Helping the buyer formulate an offer is an important benefit of having your own buyer's agent, he added.

Closing the deal

In this brave new world, there's something else that hasn't changed. Buying or selling a home is still work. You still have to find the agent or method that best suits your needs.

Chicago Association of Realtors: (312) 464-8800.

Multiple Listing Service of Northern Illinois (public site): www.mlsni.com

National Association of Realtors: www.realtor.com, has an *online* RealEstate 101 for buyers and sellers.

Helen Marshall is a Chicago free-lance writer.

GRAPHIC: "I don't think most people are comfortable with just punching it in (to the MLS) and then being left on their own," said Chris Jacobs, owner of Colonial Realtors Inc. See also related stories page 5.

LOAD-DATE: September 20, 2000

Evidentiary Exhibit Number 64

Banking Information Sources

Real Estate Finance Today
September 4, 2000
SECTION: Pg. 8 Vol. 17 No. 34 ISSN: 07420021
ACC-NO: 59984825
LENGTH: 884 words

HEADLINE: New commercial site goes *online*

BYLINE: Murray, Michael

HIGHLIGHT:

The Web site combines proerty information and financing.

BODY:

MortgageRamp.com and PropertyFirst.com Inc. are teaming up for *online* commercial real estate transactions. Under the agreement, PropertyFirst.com will provide commercial real estate information and services to MortgageRamp.com customers enabling them to obtain detailed property characteristics, and view rent rolls and financial information.

FULL TEXT:

Mortgage Ramp.com and PropertyFirst.com Inc. are teaming up for *online* commercial real estate transactions.

Under the agreement, PropertyFirst.com, Los Angeles, will provide commercial real estate information and services to MortgageRamp.com customers enabling them to obtain detailed property characteristics, and view rent rolls and financial information.

"When you look at PropertyFirst.com and you look at what we do, which is the mortgage side, there is an obvious plausible connection," said Michael Greco, chief executive officer, MortgageRamp.com, Charlotte, N.C. "We complete the financial services circle for them."

Users of PropertyFirst.com will be able to pursue and arrange financing for property sales through one integrated technology platform from Mortgage Ramp.com.

"Our view of ourselves is more than just an *online* bulletin board for property listings, buildings for sale or spaces for lease," said Don Miller, executive vice president and chief operating officer, PropertyFirst.com. "MortgageRamp brings us world class, *online* commercial mortgage services to help the buyers on our site that want to turn themselves into borrowers. It connects borrowers with lending institutions and other capital providers. It helps add to our overall vision on our site of being a place where deals get done."

PropertyFirst.com's current inventory of for-sale property listings, which exceeds $36 billion, comes from firms such as CB Richard Ellis, Cushman & Wakefield, Jones Lang LaSalle and Transwestern commercial Services.

Miller said that PropertyFirst.com wants to add title insurance, escrow services, engineering and environmental service providers to close a commercial real estate transaction. "This is the first and important step in completing that overall transaction platform," he said.

PropertyFirst.com has been in active discussions with other organizations and service providers to bring the company's users access to other services in addition to commercial mortgages, according to Miller.

"PropertyFirst.com brings us a large portfolio in excess of $30 billion dollars in properties for sale and lease," Greco said. 'Therefore, there is a large market of opportunity for us to get our message out to a large number of users in one place and that is very attractive for us as well.

"We are not just a link," Greco added.

"This is not that kind of arrangement. This is a functional relationship. They'll be able to use our technology. We are actually putting it in their site in order to perform the matching functions, screening functions and scrubbing functions for the real estate finance area."

Greco said that MortgageRamp.com is using information that PropertyFirst.com has gathered from the listing and property leasing function to create the deal information so that MortgageRamp.com can provide quotes and information that PropertyFirst.com needs for completing the transaction.

"We're adding new functionality to what they already do," Greco said. "If someone wants a loan at PropertyFirst, they have nowhere to go until we show up."

The result could be expedited commercial property sales with more efficient pricing and faster closings, in some cases in as few as 10 days, according to MortgageRamp.com officials.

"I think we can do 95 percent of a commercial real estate transaction *online*," Greco said.

He pointed out that MortgageRamp.com can provide an end-to-end solution where it can source the loan, scrub, screen, underwrite and deliver it to the lender. The company can also close the loan for the lender and send it to securitization.

"What we can't do today, because the laws won't allow it, is sign up a borrower document-wise *online*. That is still a paper process," Greco said. "When the laws are acceptable, we will be able to incorporate 100 percent."

But Miller said that commercial real estate finance deals remain a very complex and non-standardized transaction.

"No one is going to buy a piece of property *online* without having looked at it, gone to see it and kick the tires," Miller said.

However, he pointed out that buyers could find properties to purchase *online* that have "robust and complete information" so that the buyer can determine whether it is worth investing time and energy into the property.

Greco said that the commercial loan still needs human intervention.

"What technology can do is filter significant pieces of information and deliver it in a very articulate, easy-to-read and easy-tounderstand manner so that the decision can be made quickly in a few hours time," Greco said. "But I still put human beings at the switch. The decision-making intelligence of the technology is not there yet for commercial real estate."

"Our view is that the transactions will get started *online*," Miller said. "I think they can be helped to be streamlined and made more cost effective. But, at an appropriate point, the baton will be passed to a traditional bricks and mortar type of environment."

LOAD-DATE: September 29, 2000

Evidentiary Exhibit Number 65

Business Dateline

Citybusiness

September 1, 2000

SECTION: Vol. 18, No. 14; Pg. 8; ISSN: 08833044

B&H-ACC-NO: 59786373

DOC-REF-NO: MNCB-2200-11

LENGTH: 615 words

HEADLINE: YAPSTONE ASSISTS *ONLINE* PAYMENT

BYLINE:

Reilly, Mark

BODY:

As it launches an *online* service for electronic bill payments, a Minnetonka start-up firm is looking to put a New-Economy spin on some decidedly Old-Economy transactions: small-scale apartment rentals and driveway-level used car sales.

The company, YapStone Inc., last month launched a Web-based service that provides electronic credit card transactions for individual landlords and car sellers sales that typically would require personal checks or cash. The company, which raised $2 million in financing this year, expects to close on another $3 million later this month.

"Larger landlords and auto dealers, they do enough volume that they can afford to offer credit-card purchases," said YapStone president Kirk Honour. Because banks tie credit-card fees to the number of sales, smaller players that might have only a handful of transactions per year often can't afford to offer creditcard sales. By aggregating thousands of individual transactions together through its site, Honour said, YapStone can command better rates and offer its subscribers credit-payment options.

The company launched its rental site in early August, targeting smaller landlords. YapStone debuted the second portion of its business, aimed at individual car Wes, last week.

Similar payment-assistance technology has popped up for other types of *online* purchases, such as the PayPal system used on *Internet* auction house eBay. Other companies, such as RentPayment.com in San Francisco, have already targeted the real estate market' But YapStone will be one of the first entrants pursuing usedcar deals, Honour said, and several of its executives previously worked at the new-car sales site Autobytel.com.

It was Honour's experience with the quirks of the $45 billion, individual-seller used-car market that led to the idea behind YapStone. "I got the idea when I was trying to buy a motorcycle at a garage sale," he said. The bike's owner wouldn't accept a $2,000 personal check, and ATMs wouldn't give Honour enough cash to cover the sale, he said. "If we could have used a credit card there'd be no problem," he said. "But I was stuck and the seller was stuck."

As the business plan developed, Honour and other officials added the rental industry to the mix because of several key similarities between the markets. "They're both large, pretty infrequent purchases, with a lot of documentation," he said. The documentation is crucial it lets YapStone build credit histories of buyers and

sellers and quickly determine if they're good risks. It also lets car buyers quickly perform "lemon checks" on a vehicle. "If you've got a cell phone, you can call us and do the check from the driveway while you're looking at the car," Honour said.

So far, the company's funding has come from venture capitalists such as Villante Capital Partners and through real estate investors, such as individual officials at Colony Capital Group; both firms are California-based. "They're playing the right way with the *Internet* - getting rid of inefficiencies," said Jonathon Grunzweig, a principal at Colony. YapStone employs 20 people, and Honour projects $7.4 million in first-year transactions (YapStone takes a portion of each transaction as a fee) and profitability in early 2001.

But the company has suffered the same fund-raising woes faced by many *Internet* companies this year. Earlier in the year, Honour had hoped to raise as much as $20 million in YapStone's second round; the technology falloff has forced the company to significantly lower its sights. "We really got hammered on that," Honour acknowledged. "Investors are being a lot more cautious since the market correction."

LOAD-DATE: October 3, 2000

Evidentiary Exhibit Number 66

Contra Costa Sun (California)

August 16, 2000 Wednesday FINAL EDITION

SECTION: NEWS; Pg. 14

LENGTH: 1170 words

HEADLINE: EBAY AUCTIONS HOMES *ONLINE*, NEW HOME SALES DIP FOR THIRD MONTH

BODY:

Nowadays, energy conservation spurred by the 1970s crisis is ingrained in many of us, but have we learned to shut off the water while we're brushing our teeth? For many tenants who don't pay directly for water, water conservation isn't high on the priority list.

As water becomes scarcer, especially in warmer states, such as Texas, Florida, Arizona and California, conservationists are looking for ways to conserve our natural resource and landlords are looking for ways to minimize their expenses.

"The cost of water has been one of the biggest and most unpredictable operating expenses because utilities are responding to various federal mandates," said Eileen Lee, vice-president of environment for the Washington, D.C.-based National Multi Housing Council. "Many property owners have opted to install metering devices to monitor water consumption in a particular unit."

Water and sewer costs increased about 45 percent in the 1990s, so direct water meters are becoming more common in new apartment buildings.

The California Public Utilities Commission is formulating a plan where tenants are sub-metered and billed by the landlord. Some states, such as Massachusetts, prohibit sub-metering, while California allows it as long as charges aren't more than water company rates.

Billing the tenant based on allocation, often called the ratio utility billing system, requires payment based on a percentage of the landlord's water bill calculated using the number of occupants, unit square footage, the number of taps, or other factors. It's the most controversial of the four means of water billing, as some tenant groups feel the formulas are inaccurate.

In some cases, an outside company bills tenants, although some critics worry it appears landlords profit on water bills.

Other tenant worries include landlords passing on sub-metering installation costs through rent hikes as they start charging for water.

Unfortunately, there are few resources for tenants, since most states have no regulations. However, Texas tenants have the allocation process state regulated.

Tenants can try local consumer groups, tenant groups, apartment associations, state PUCs, or city rent board officials for information about water metering.

New home sales dip

New home sales fell again in June, the third straight monthly decline, giving a strong indication that the Federal Reserve Board's effort to cool the economy through interest rate hikes is taking hold.

Sales of new single-family houses were at an annualized rate of 829,000, down 3.7 percent from the revised May rate of 861,000, and 13 percent below the June 1999 rate of 948,000, according to the U.S. Department of Commerce.

The June median sales price of new houses was $159,000. At the end of June, the seasonally adjusted estimate of new houses for sale was 327,000, representing a 4.9-month supply at current sales rates.

The continued cooling followed six interest rate hikes by the Fed over the past year, and suggested to some analysts that rates might remain unchanged during the Aug. 22 Open Market Committee meeting.

EBay debuts home auctions

Internet auction site eBay.com (www.ebay.com) is selling homes on the *Internet* through a partnership with web realty broker zip

Realty.com (www.ziprealty.com).

San Jose-based eBay, with about 16 million registered users, is growing at a monthly clip of about 3 million.

About 50 residential properties were listed last week.

Listing at eBay will cost $10 through the end of August, when the discount ends and the regular price of $50 kicks in.

Information posted at the real estate section said home sellers in zipRealty's markets : including Boston, Philadelphia, Baltimore, Atlanta, Dallas, Phoenix, San Diego, Los Angeles and Orange County, the San Francisco Bay Area, California's Central Valley, Seattle, Washington D.C., and Chicago : can sell through zipRealty as well as eBay and get off- and *online* management support from zipRealty.

The site said: "...once you become a client of zipRealty, zipRealty will provide you access to thousands of listings in the relevant area. If you would like to use eBay to help you sell your own property, you can list your property in the real estate category."

ZipRealty will list the properties on eBay, as well as in local multiple listing service. Sellers wanting zipRealty as an agent, need to register with zipRealty.

At an auction's end, a seller can contact bidders and close transactions offline.

Berkeley-based zipRealty is perhaps best known for offering thousands in savings for consumers at a deal's closure, targeted growth in metropolitan areas and a spiffy new fleet of about 20 Volkswagen bugs called zipMobiles at the ready to fly to any problem situation with local field agents.

EBay includes photos, physical descriptions, auction start and end times and an unlisted minimum seller's price. Properties are divided into different categories including residential, vacation homes, commercial and land.

EBay acknowledged at its real estate section that bidding isn't binding.

Are WEr selves?

Amazed at some of the newest ideas for the *Internet*? As in WErAmazed?

That's Jim Journigan's preferred method. The self-styled "*Internet* visionary" is founder and president of San Diego-based WErDomainNames.com (www.werdomainnames.com), which sells domain names for real estate markets in Southern California and other "prominent regions" across the U.S. and Canada.

Names such as "WErSanDiegoRealEstate.com," "WErLakeTahoeRealEstate.com," and "WErNewportBeachRealEstate.com" can be bought.

Journigan said it's an innovative solution to the problem of finding distinctive and easy-to-remember domain names.

"(The *Internet*) is an important communication media for real estate sales professionals to reach home buyers, as well as perspective home sellers," he claimed. "That's why this new collection of domain names is an important addition to any high-profile real estate marketing strategy. A WEr' domain address is the perfect tool to link real estate shoppers to a broker's primary Web site."

Mortgage rates hold stedy

The average rate for a single-family mortgage in major metro areas held nearly steady as of Aug. 2, based on a Bankrate.com (www.bankrate.com) national survey.

The national average slipped to 8.15 percent, from the previous week's 8.16 percent, with points moving to 0.35, from 0.34, based on a 30-year, 80 percent value loan on a single-family home.

The major metro area rates were:

*Chicago, rising to 8.27 percent, from 8.26 percent.

*Philadelphia, slipping to 8.22 percent, from 8.24 percent.

*San Francisco, sliding to 8.13 percent, from 8.14 percent.

*Washington, D.C., rising to 8.1 percent, from 8.07 percent.

*Boston, bumping up to 8.06 percent, from 8.05 percent.

*Los Angeles, dropping to 7.99 percent, from 8.1 percent.

Inman News writers Leta Herman, Carl Holcombe, Julie Clairmont and Allison Landa contributed to this report.

LOAD-DATE: February 4, 2002

Evidentiary Exhibit Number 67

Business Wire

August 1, 2000, Tuesday

DISTRIBUTION: Business Editors/High-Tech & Real Estate Writers

LENGTH: 761 words

HEADLINE: Rent Tech Builds *Online* Renter Support Services With ShopTok Instant Messaging Application; Now *Online* Renters Receive Live Help Accessing Bay Area Rental Information with TokSupport

DATELINE: SAN FRANCISCO, Aug. 1, 2000

BODY:

Rent Tech, the largest retail rental and rooming service in San Francisco, announced a partnership with ShopTok, an ASP specializing in blended sales and service applications that drive revenue for *online* businesses. Rent Tech is building up its *online* customer support offerings with live *online* help with TokSupport instant messaging application.

Rent Tech is now able to guide tenants through the database of San Francisco rental room listings, help them fill out their rental resume, and help them sign up for *online* credit reports. TokSupport enables Rent Tech to help their clients receive fast, courteous, professional advice from experienced rental agents.

"TokSupport enables us to talk directly with our tenets, while we help them find the living situation that best suits their needs," said Grey Todd, President, Rent Tech. "Our clients benefit from having their most pressing questions answered by our knowledgeable staff. Through the TokSupport technology, can guide them through the listings, pointing out rentals that fit their criteria."

"TokSupport enables Rent Tech to offer more than just customer service for their *online* clients," said Melinda Cuthbert, CEO, ShopTok. "ShopTok applications create new channels for revenue. Rent Tech can reach its clients through phone, pager, email and now through instant messaging. We are creating innovative ways in which Rent Tech can provide customer service and sales support, helping customers find their dream homes faster and easier than by any other method. TokSupport provides not just a new sales channel, but a better one."

About ShopTok

ShopTok, Inc. (San Francisco, CA) is first-to-market with a proprietary applications platform that helps e-businesses drive sales and profitability. ShopTok's platform gives e-commerce sites the ability to turn every customer interaction into a sale by engaging their customers throughout the buying process, presenting highly customized product recommendations and closing the sale. By combining conversation-driven applications and a powerful data-mining engine and knowledge base, ShopTok's platform provides a more personalized *online* shopper support, builds brand loyalty, boosts *online* revenue and reduces operational costs for major brands such as Sega.com, CornerHardware.com, and NextOffice.com. The company was founded in 1998 by seasoned veterans from USWeb/CKS, HotWired, Organic, Mitsubishi, and Foote, Cone & Belding. ShopTok is privately held and backed by leading venture firms DynaFund, Vanguard Ventures, and Forrest Binkley and Brown. Additional information can be found at http://www.shoptok.com.

About Rent Tech

Rent Tech is the largest retail rental and rooming service in San Francisco, providing support for as many as 3,000 customers and landlords each month. Founded in 1995, Rent Tech was the first prepaid rental listing service to utilize the *Internet* and other technologies as a means of distributing apartment vacancy and roommate information to its customers. Rent Tech lists vacancies for landlords and roommates at no charge, deriving its revenue from fees paid by individuals looking for listings of vacant rental units and/or rooms. Rent Tech's proprietary software distributes these listings hourly via the *Internet*, fax or alphanumeric pager. In addition, the company provides its rental customers with maps and photos, making it easy for customers to preview and locate the vacancies. Other optional services include credit and eviction searches and cellular phone rentals. Rent Tech offices also provide a customer service center where, at no charge, clients may use phones for local calling or avail themselves of computers and high-speed *Internet* access.

In October 1999, Rent Tech purchased Rental Solutions, the Bay Area's premiere full service rental agency, specializing in both long and short-term housing in San Francisco and Berkeley. In June of 2000, Rent Tech acquired SpringStreet.com, the Seattle Apartment Source's current leased location at 905 East Pike Street. Rent Tech's listings will be now available both on SpringStreet.com as well as at Rent Tech's new walk-in service center. Consumers in the tight rental market of Seattle will benefit by gaining access to significant new apartment and rental content. To demo the program in a retail environment, visit Rent Tech at www.renttech.com.

CONTACT: ShopTok
Allison Witter, 415/503-5621
allison.witter@shoptok.com
or
Market Link
Karen Frishman, 415/362-7610
karen@marklink.com

URL: http://www.businesswire.com
LOAD-DATE: August 2, 2000

Evidentiary Exhibit Number 68

PR NEWSWIRE
July 19, 2000

LENGTH: 1452 words
HEADLINE: Homestore.com, Inc. Reports 252% Growth in Second -2-
BODY:

CreSenda Wireless agreed to develop and co-market the first product in its Wireless Professional Series (SM) -- WirelessRealty (SM) -- with Homestore.com. The new service, currently in beta testing, consists of a personal handheld device, wireless modem and business-critical content and applications for real estate professionals.

Management Additions

Allan Merrill was appointed president of HomeBuilder.com, the web's most popular resource for new-home buying and building and the engine for Homestore.com's "New Homes" site. Merrill joins Homestore.com after 13 years with Warburg Dillon Reed, where he served most recently as co-head of the investment bank's Global Resources Group, overseeing the construction and building materials sectors, among others. Merrill brings strong relationships with many of the leading companies in housing, construction and building materials.

Patrick R. Whelan was appointed president of SpringStreet.com, Homestore.com's full-service apartment rental site. Whelan brings more than 18 years experience in commercial real estate and corporate finance, most recently serving as president of Archstone Communities, Inc. and chief operating officer of Archstone Communities Trust. Whelan also has held senior management positions with Security Capital Group, Trammel Crow Company and General Electric Capital Corporation.

Steve Ozonian was appointed president of Realtor.com(R), the number one real estate site on the *Internet* and the official *Internet* site of the National Association of Realtors(R). Ozonian previously served as chairman and chief executive officer of Prudential Real Estate and Relocation Services, where he led the development of ground-breaking computer systems, software and web-based marketing strategies for the real estate sales and relocation industry.

Jeff Travelstead was appointed chief operating officer of Realtor.com(R). Travelstead previously served as senior vice president of information technology for Prudential Real Estate and Relocation Services, where he developed e-business strategies and technology initiatives. While at Prudential, Travelstead crafted new, more efficient methods to tap existing information systems for tech-based information and delivery tools to consumers and corporate clients.

About Homestore.com, Inc.

Homestore.com, Inc. (Nasdaq: HOMS) is the leading network of sites on the *Internet* for home and real estate-related information, products and services. Homestore.com, Inc.'s family of web sites include Homestore.com, Realtor.com(R), HomeBuilder.com, SpringStreet.com, Remodel.com(TM) and HomeFair.com web sites. Consumers can view over 1.4 million new and existing homes for sale and find broker and agent services on Realtor.com(R), the official *Internet* site of the National Association of Realtors(R). Consumers

searching for new homes can find more than 130,000 models, new homes and built to suit plans on HomeBuilder.com, the official new homes site of the National Association of Home Builders. Consumers interested in renting an apartment will find listing information from more than 45,000 properties in more than 6,000 cities on SpringStreet.com. Homestore.com's remodeling area covers home improvement needs for both consumers and remodeling professionals. Comprehensive moving and relocation information on the *Internet* is available from HomeFair.com. Homestore.com also has content distribution relationships with America *Online*, Netscape and Excite@Home.

(1) Unique users, and user minutes are based on Media Metrix, 2+.

This press release contains forward-looking statements that are subject to material risks and uncertainties. Actual results may differ materially and reported results should not be considered as an indicator of future performance. Risks and uncertainties that may affect our future results include, but are not limited to, the following: our ability to maintain and manage favorable agreements and relationships with the National Association of Realtors, the National Association of Home Builders and *Internet* portals; our ability to continue to obtain a large percentage of available real property listings; our ability to obtain such listings on an exclusive basis; our ability to manage rapid growth, both internally and through acquisitions; changes in the real estate markets; seasonality and other fluctuations in the company's financial results, our ability to maintain high reliability for our server-based web services; and uncertainty as to the timing and amount of future *Internet*-related revenue and profits. The matters discussed in this press release also involve risks and uncertainties described from time to time in our filings with the Securities and Exchange Commission (SEC). In particular, see "Risk Factors" in the final prospectus included in our registration statement declared effective by the SEC on January 26, 2000 and also see our Annual Report on Form 10-K for the year ended December 31, 1999. We assume no duty to update the information in this press release if any forward-looking statement later turns out to be inaccurate.

(FINANCIAL STATEMENT TABLES FOLLOW)

Basis of Presentation of Financial Information. Prior to February 4, 1999, the company operated under a complex legal and operating structure in which Homestore.com, Inc. was a holding company whose sole business was managing its investment in the operating entity. Accordingly, through February 4, 1999, this investment was accounted for under the equity method which means Homestore.com, Inc. did not record the results of operations related to the operating entity. In addition, the company completed its acquisitions of SpringStreet.com and HomeFair.com on June 30, 1999 and October 31, 1999, respectively.

Pro forma financial information includes a comparison of the results of operations of Homestore.com, Inc. as if the reorganization of the company's holding company structure on February 4, 1999 and the SpringStreet.com and HomeFair.com acquisitions occurred January 1, 1999. This pro forma information has been presented to assist investors in evaluating our historical performance with current results. Homestore.com, Inc. Consolidated Statements of Operations - Pro Forma Basis (in thousands, except per share amounts) (unaudited) For the Three Months For the Six Months Ended June 30, Ended June 30, 2000 1999 2000 1999 Revenues $ 50,152 $ 14,246 $ 88,751 $ 24,655 Cost of revenues 13,285 5,321 23,845 9,874 Gross profit 36,867 8,925 64,906 14,781 Operating expenses: Sales and marketing 30,440 19,760 60,225 34,720 Product development 3,598 1,609 5,438 3,000 General and administrative 11,859 6,926 22,674 12,026 Amortization of intangible assets 10,935 7,022 19,327 14,036 Stock-based charges 11,021 4,859 21,835 8,062 Total operating expenses 67,853 40,176 129,499 71,844 Loss from operations (30,986) (31,251) (64,593) (57,063) Interest and other income (expense), net 6,274 (1,548) 10,669 (3,139) Net loss $ (24,712) $ (32,799) $ (53,924) $ (60,202)

Basic and diluted net loss per share $ (0.31) $ (0.56) $ (0.70) $ (1.06) Shares used to calculate basic and diluted net loss per share 80,153 58,735 77,102 56,662 Net loss, excluding non-cash charges related to the amortization of intangible assets and stock-based charges $ (2,756) $ (20,918) $ (12,762) $ (38,104) Basic and diluted net loss per share, excluding non-cash charges related to the amortization of intangible assets and stock-based charges $ (0.03) $ (0.36) $ (0.17) $ (0.67) Homestore.com, Inc. Consolidated Statements of Operations - GAAP Basis (in thousands, except per share amounts) (unaudited) For the Three Months For the Six Months Ended June 30, Ended June 30, 2000 1999 2000 1999 Revenues $ 50,152 $ 11,016 $ 88,751 $ 16,586 Cost of revenues 13,285 4,361 23,845 7,110 Gross profit 36,867 6,655 64,906 9,476 Operating expenses: Sales and marketing 30,440 15,604 60,225 24,361 Product development 3,598 1,037 5,438 1,368 General and administrative 11,859 3,932 22,674 5,918 Amortization of intangible assets 10,935 789 19,327 1,311 Stock-based charges 11,021 3,610 21,835 5,250 Total operating expenses 67,853 24,972 129,499 38,208 Loss from operations (30,986) (18,317) (64,593) (28,732) Interest and other income (expense), net 6,274 37 10,669 (34) Net loss $ (24,712) $ (18,280) $ (53,924) $ (28,766) Basic and diluted net loss per share $ (0.31) $ (0.75) $ (0.70) $ (1.40) Shares used to calculate basic and diluted net loss per share 80,153 24,350 77,102 20,502 Net loss, excluding non-cash charges related to the amortization of intangible assets and stock-based charges $ (2,756) $ (13,881) $ (12,762) $ (22,205) Basic and dilutednet loss

LOAD-DATE: September 5, 2000

Evidentiary Exhibit Number 69

Saint Paul Pioneer Press (Minnesota)
July 2, 2000 Sunday

SECTION: BUSINESS; Pg. 5D
LENGTH: 1841 words

HEADLINE: HOMESERVICES.COM IS ATTEMPTING TO STAY IN TOUCH LONG AFTER CLOSING

BYLINE: Kevin Maler Staff Writer

BODY:

There's nothing quite like HomeServices.com. And that's a problem.

HomeServices.com went public at $15 in October, at the tail-end of the infatuation with *Internet* stocks. It watched its shares sink as low as $8 in April before they turned back up. For an *Internet* stock, that 47 percent erosion was fairly modest - many high-fliers lost 60 percent or more. At Friday's close of $11.25, the stock is only 25 percent off its offering price.

But then, HomeServices isn't a true dot-com. It's a holding company for one of the largest residential real estate firms in the United States, with names like Edina Realty under its umbrella.

Revenue from the *Internet* accounted for only a few million for a firm that would have annualized revenue of about $500 million. Even after a few years, executives see only 10 percent of revenue coming from the *Internet*.

Even the dot-com at the end of HomeServices was something of an accident, not a bid to cash in on last year's craze. By putting the moniker at the end of HomeServices, the company was able to get a service mark on the name, which otherwise would have been too generic, says Ron Peltier, the firm's president and chief executive.

But technology and the *Internet* are a central part of HomeServices' strategy. Most people have very close relationships with their real estate agent when they buy a house - confiding their needs, incomes and plans - but that relationship abruptly ends at the closing. With typical homeowners selling every seven to nine years, HomeServices aims to use the Web to maintain that relationship throughout the home "life cycle."

For example, its site includes a service called The Hook Up that lets a new homebuyer reconnect the myriad services, from phone and *Internet* to electricity and gas, for free (HomeServices collects modest referral fees from some of these providers in the process). Another feature HomeServices is rolling out now, The Fix Up, connects homeowners with contractors and service providers.

Using the *Internet* to build closer relationships with customers, of course, has become a mantra in corporate America. But HomeServices doesn't really have any true publicly traded peers. The real estate industry remains a fragmented business of small independent firms; the other large players aren't stand-alone companies. Coldwell Banker, for example, is owned by Cendant Corp., which owns a diverse group of franchise concepts.

"Our problem is we are a universe of one," Peltier says. "Analysts and bankers throw us in the financial services sector, and they have all suffered tremendously because of rising interest rates. Without any comparables, we are left to fend for ourselves." Unlike most dot-com executives, Peltier welcomes a shift to value investing.

The stock trades at 7.4 times expected earnings per share. Peltier argues that HomeServices should at least be valued like consumer finance firms, which trade at 25 to 35 times expected earnings. He observes that the residential real estate industry offers tremendous opportunity for consolidation, with the largest 500 companies accounting for only 19 percent of total transactions.

The deals add to earnings per share, Peltier says, and typically smaller firms don't offer additional services like title insurance, inspections, home warranties and such because they don't have the size to justify it.

"The trouble with many of these (smaller firms) is they're very good brokerage operations, but they don't have scalability or critical mass, even on front-end services and title," Peltier says.

Using the *Internet*, HomeServices hopes to extend that menu of services well past the closing as homeowners embrace the Web. But, as the securities brokerage industry will tell you, when it comes to the Web, be careful what you wish for.

Investors of many stripes have embraced *online* trading, but the revolution also forced firms to change their business model. Securities firms used to make their money on commissions from trades. Now trades are practically free, and full-service firms charge clients, say, 1 percent of assets to manage an account.

Will the *Internet* - which makes it easy to scour listings from home - decimate the hefty 7 percent commissions home sellers pay for a broker's service, as it did with trading commissions?

Peltier contends that early predictions a few years ago that the industry would essentially be replaced by virtual brokers were wrong. He notes that stocks are a commodity - a share of IBM is the same wherever you buy it - while each house is unique. "If you want to buy a four-bedroom colonial, I could put it in 10 locations in the Twin Cities and the price would vary by $1 million," he says.

That makes seeing a house essential to the transaction. Buying a home is also an emotional investment, and brokers provide consulting and negotiating expertise. But he agrees that the way fees are now paid is likely to change, perhaps to a model where both buyer and seller pay commissions.

Seema Williams, a senior analyst with Forrester Research in Cambridge, Mass., agrees that change is in store for the industry but that brokers won't disappear. They do add value to a complex transaction, she says. "Will that warrant 7 percent? Probably not. Will they warrant something? Yes," she said.

Weak real estate agents who act as little more than taxi drivers to properties, she says, are most vulnerable.

Anecdotally, some brokers say the Web speeds up transactions, because prospective buyers who surf the *Internet* need to visit fewer homes and are better educated about the neighborhoods. That allows them to be more productive, but they will take business from less productive competitors.

But the Web may prove less valuable as a tool to keep recent homebuyers' loyalty until the next move, Williams said. Building a brand name for the site is difficult - though piggybacking off established real estate firms helps - and a host of "home-oriented" competitors are vying for attention. Other large real estate firms have similar offerings, too.

Then there's the time between transactions. "It's tough to maintain a relationship for seven years. Once you have your plumber, your lawn service, are you going to keep coming back (to the site)? It's tough to stretch that out that long for what's a remarkably infrequent purchase," she said.

Target

Softening retail sales nationally has made for a lackluster year for nearly all retail stocks. But Target has fared worse than many of its peers. This year, the stock has lost 21 percent of its value, while the S&P retail-stores index is down 16.5 percent. The slide has been especially pronounced since mid-May after the stock had regained much of its ground. Since then, Target shares are down 18.3 percent while the index lost 1.7 percent.

Why is the stock being relegated to the bargain bin?

The short answer is apparel. Target has differentiated itself from rival Wal-Mart by positioning itself as a fashion-oriented discounter that's a cut above its competitors. In March, for example, it signed a deal with designer Mossimo to license its sportswear brand.

Analysts have applauded the strategy. But with little new in the fashion world, apparel sales are soft, and Target feels it in all its divisions, from the namesake discount chain to Mervyn's and the department stores.

The softness shows up most clearly in Target's same-store sales, a key figure that measures sales from stores open more than a year. In May, the Target division managed same-store increases of only 2.6 percent, while Mervyn's was flat and the department stores fell 5.9 percent. June numbers will probably offer more of the same.

"I think that Target is beautifully run," said Bob Buchanan, an analyst with A.G. Edwards & Co. who praises the discount chain's merchandising and execution. But the company's emphasis on apparel sales makes it more vulnerable than other discounters, he says, rating the stock a "hold." The problem: Fashion trends haven't changed for a couple of years, and shoppers are bored with them.

Target's same-store sales are below the group's, he said, and the department stores' 5 percent slip is "awful" when other department store chains are flat or down only a couple of percentage points.

The weakness could mean Target will miss its estimated second quarter earnings, even though management hasn't indicated it would, said Steven Roorda, senior investment analyst for American Express. Slowing sales will hit the Mervyn's and department store groups harder than Target, and could bring renewed pressure from shareholders to take action on the divisions - though he says a sale would be dilutive and is unlikely.

But the stock's slide may not go much further. "I think there's a fair amount of the weakness already built into the price," says Dean Ramos, an analyst with George K. Baum & Co. "We don't think there's a substantial amount of downside. Having said that, all bets are off if the economy goes in a tailspin and a lot of these companies start missing numbers."

Mesaba

While shares of Northwest Airlines stock have surged in the past month on speculation that the industry could go through a round of consolidation, the regional carrier that feeds Northwest has slumped. Since May 24, Mesaba's stock has fallen 20.7 percent, and it's down 16.4 percent for the year.

But traders probably aren't fretting over the role of regional airlines in the unlikely event that the U.S. Justice Department gives a green light to a proposed merger between United Airlines and U.S. Airways. Other regionals, in fact, are up this year, including Atlantic Coast Airlines Holdings, up 33.7 percent.

Rather, Mesaba's share price reflects its perennial challenge: how to find growth when the near-term opportunities with Northwest - which holds a big stake in Mesaba and has board representation - are limited. The issue was recently underscored when Mesaba took possession of its 36th AVRO jet, the last it will get from Northwest under its current agreement.

Jamie Baker, a regional analyst with PaineWebber in New York, initiated coverage of the stock May 18 with a "neutral." "With Mesaba, their only hope for material profit growth is material capacity growth, and that's what they lack right now," he said. The regional could add capacity with 44-seat or smaller jets that aren't restricted by Northwest's pilot contract, but he doesn't see that happening soon.

In February, company executives told the Pioneer Press they're looking at other avenues for growth, including acquisitions, a story Baker says they've shared with analysts.

But talk of the plans among Wall Street types has seemed to do little for the stock, and it will probably remain grounded until a picture of how it will grow turns clearer.

Kevin Maler writes about the stock market and Twin Cities stocks. He can be seen at 11.45 a.m. Mondays on Channel 5 "Eyewitness News Midday." Reach him at kmaler@pioneerpress.com or (651) 228-5421.

LOAD-DATE: January 30, 2002

Evidentiary Exhibit Number 70

Contra Costa Sun (California)
March 29, 2000 Wednesday FINAL EDITION
SECTION: NEWS; Realty Trends; Pg. 13
LENGTH: 993 words

HEADLINE: BABY-BOOM BUYERS SETTLE IN MIDDLE AMERICA DURING THEIR AUGUST YEARS

BYLINE: Warren Lutz

BODY:

If you're prospecting in real estate investment and want to buy somewhere before the urban retreating baby-boomers arrive, you might want to pay attention to a study released at the Milken Institute's (www.milken-inst.org) Global 2000 Conference.

It appears that small- and medium-sized metropolitan areas in the "heartland" are where aging boomers will settle in the coming years. The West and South will be favorites, while the states with the fastest-growing elderly populations will be Nevada, Alaska, Arizona, Utah, Colorado and New Mexico, the report said.

Large coastal "gateway" cities such as New York, Los Angeles and Miami, meanwhile, will get younger and attract larger immigrant populations. The study also said African Americans seemed to be migrating back to the South.

Primarily driving the movement are baby-boomers exercising greater professional and financial freedom. Boomers were split into two age groups, 55- to 65-year-old retirees and a 45- to 54-year-old group of recent empty nesters with newfound mobility.

Online brokerages expand

Online real estate brokerages may operate in the virtual world, but in the real world, someone still has to be on hand to open the door for a prospective homebuyer.

In order to accommodate the growing number of clients across the nation, two California firms have expanded their service areas.

Campbell-based eHome.com (www.ehome.com) followed its November 1999 launch in the San Francisco Bay Area with a recent launch in Southern California.

With regional offices in San Diego, Glendale and Irvine, eHome plans to offer personalized traditional services and low-fixed fees to consumers living in Los Angeles, Orange and San Diego counties.

Ehome.com matches homebuyers and sellers with licensed, non-commissioned real estate agents in local areas. Home sellers pay a flat service fee instead of the typical 6 percent commission to agents.

Some of eHome.com's services include 360-degree virtual home tours, access to in-house lenders and live *online* chats with agents. Also, e-mail alerts can be sent to buyers when a house becomes available that matches their search criteria.

Another *online* brokerage, zipRealty.com (www.ziprealty.com) has also expanded by adding agents in Dallas to represent the company.

Berkeley-based zipRealty.com now serves seven Western and Southern metropolitan cities through various local and *online* agents and brokers.

Web site for apartment rentals

Online home-selling auctions have gained some popularity recently, but now a new company is promising a launch of a Web-based bidding service for apartment rentals.

West Hartford, Conn.-based Qrent (www.qrent.com) will launch later this year in test markets in Boston and San Francisco and plans to be in 12 major cities in three years. The site will list rental properties for owners and property managers. Prospective tenants can join an *online* auction to determine an apartment's rent.

Qrent is targeting "busy professionals seeking a new home in the high-demand city metros across the country."

Potential tenants can check apartment availability, whether others are interested, the most recent bid and what leases are on similar apartments.

Qrent also plans to market the properties, help select tenants and negotiate rental amounts and leases. The company was founded less than a year ago.

Home sales, starts will slip

A series of interest rate hikes is expected to take its toll this year on sales, the number of homes built and the prices they fetch, according to the latest report from the National Association of Realtors (www.realtor.com).

U.S. economic growth should hold steady this year, but housing starts and sales should drop as prices rise, according to NAR's latest report on the industry, called "Real Estate Outlook: Market Trends & Insights."

It predicted existing home sales will drop 6.7 percent to 4.84 million units.

New home sales are expected to slip 3.6 percent to 874,000 units. Housing starts will dry up slightly, slipping to 1.49 million units, an 11.1 percent drop.

The drop in home sales and starts was blamed in part on rising mortgage rates brought on by the Federal Reserve's rate hikes to prevent the economy from overheating.

Thirty-year fixed-rate mortgages are expected to average 8.5 percent this year, while adjustable-rate mortgages should average 6.8 percent.

Prices, however, are expected to keep rising. The median existing-home price is expected to rise this year by 2.7 percent to $136,000. The median price of a new home is expected to grow 6.6 percent to $169,300.

Extra-low FHA down payments

Although home prices are likely to rise, the people who teach our children and protect our homes from fires and other hazards will have a better chance to buy homes if a federal bill passes.

The "American Homeownership and Economic Opportunity Act of 2000" was approved in the House Banking and Financial Services Committee (www.senate.gov/(tilde)banking) recently and is expected to be up for a floor vote sometime this spring.

The bill would provide reduced down payments on Federal Housing Administration (www.hud.gov/fha) loans for teachers, police, firefighters and other uniformed municipal workers. They would get 1 percent down

payment options for FHA loans and be able to delay 2.25 percent up-front FHA premium charges until loans are repaid.

For instance, a first-time borrower could have his down payment dropped to just $1,300 from $6,300 on a $130,000 home. Seniors would also get long-term care insurance easier via a FHA reverse-mortgage program as long as they waived up-front fees charged by the Department of Housing and Urban Development (www.hud.gov). Section 8 vouchers for low-income families could also be converted into one-time grants for down payments.

Inman News Features writers Allison Landa, Carl D. Holcombe and Alex Freemon contributed to this report.

LOAD-DATE: January 29, 2002

Evidentiary Exhibit Number 71

PR Newswire

March 7, 2000, Tuesday

SECTION: FINANCIAL NEWS

DISTRIBUTION: TO BUSINESS, REAL ESTATE AND TECHNOLOGY EDITORS

LENGTH: 941 words

HEADLINE: Rentals.com Names Prominent Rental Industry and Real Estate Executives To Management Team;

Internet's First Residential Rental Management Solution Garners Industry Confidence with New Hires

DATELINE: REDWOOD SHORES, Calif., March 7

BODY:

Rentals.com (http://www.rentals.com), the first *online* residential rental resource to offer a powerful, business-to-business e-commerce management solution for both property owners and renters, today appointed four prominent industry leaders to its management team: Vice President of Association and Industry Support Terry Feinberg, Director of Association and Industry Support Sheryl Tedesco, Vice President of Sales Todd Baldree, and Content and Managing Editor Corrie Anders. All four executives have extensive experience and established connections in the rental management and real estate industries.

"Rentals.com is committed to becoming the leading resource for both marketing and managing residential rentals. Terry, Sheryl, Todd, and Corrie bring invaluable, knowledge, experience and credibility to the organization," said Vince Giovannotto, co-founder, chairman, and CEO of Rentals.com. "Their appointments reinforce the company's determination to obtain the talent necessary to understand the market and provide a product that truly meets the needs of the industry. "

Terry Feinberg joins Rentals.com as Vice President of Association and Industry Support after spending the last 8 years growing the Tri-County Apartment Association into one of the nation's most successful non-profit trade associations for property owners. At Rentals.com, Terry will build strategic relationships with rental associations around the country, manage industry and association marketing, and oversee the development of the site's informational content. In addition to being a rental columnist for the San Jose Mercury News, he is a property owner who is well acquainted with the needs and concerns facing both renters and property managers in today's marketplace.

As Director of Association and Industry Support, Sheryl Tedesco will market Rentals.com to the rental management industry. Most recently, she was responsible for corporate and property marketing for Maxim Property Management, one of the nation's leading owners of rental properties. Sheryl's experience and reputation will help Rentals.com quickly gain association and industry support as she begins positioning the company within the marketplace.

"Our decision to develop an Association and Industry Support department is clearly indicative of our commitment to fully understand and address the needs of the property management industry," said Giovannotto. "Terry and Sheryl's contributions will be invaluable to the development of Rentals.com. Their contacts and reputations will help the company attract the interest and support of property owners across the nation."

As Vice President of Sales, Todd Baldree is responsible for all of Rental.com's sales efforts. This includes the development and implementation of the Company's strategic sales plan, market analysis, product positioning, and the establishment of a sales team.

He has extensive experience marketing value-added services to the real estate industry nationwide. Previously, Todd served as Vice President of Business Development for Cox CustomMedia, the premier custom publishing company in the multi-family housing and commercial real estate. He is credited with increasing Cox's revenues by more than 500% in less than four years.

Corrie Anders has spent the last 12 years as an award-winning real estate editor and reporter for the San Francisco Examiner. As Content Manager and Editor for Rentals.com, Corrie will be responsible for driving all editorial aspects of Rentals.com. While at the Examiner, he produced the paper's weekly residential real estate section and wrote features on a wide array of real estate topics, including the award-winning "American Dream" series on the difficulties new residents encounter when trying to find housing in the Northern California area. Corrie is well-versed in the needs and issues facing both property managers and renters and has worked closely with many key industry players.

"If we did not believe that Rentals.com is the future of rental management, we would never have joined the team," said Terry Feinberg "There is no doubt that the Web will play a major role in shaping the industry and that Rentals.com is the company to lead that charge."

About Rentals.com

Rentals.com (http://www.rentals.com) is bringing a powerful business-to-business e-commerce solution to rental management. Located in Redwood Shores, California and founded in February 1999, the Company is the first personalized *online* rental office designed to meet the needs of rental property owners, managers, and renters. The service offers property managers and owners the capability and tools for setting up a virtual rental management office *online*, while serving as a free, one-stop source for renters. Rentals.com was established by and for working property managers who understand the issues and challenges facing both owners and renters. Rentals.com is funded by Sequoia Capital and SOFTBANK.

Company Information:

Rentals.com
3000 Bridge Parkway, Suite 103
Redwood Shores, CA 94065
Ph: 650-622-2600
Fax: 650-622-2601
info@rentals.com
www.rentals.com

Media Contact Information:

Diahann Reyes
Neale-May & Partners
Ph: 650-328-5555 X264
Fax: 650-328-5016
dreyes@nealemay.com

SOURCE Rentals.com

CONTACT: Diahann Reyes of Neale-May & Partners, 650-328-5555, ext. 264, or fax, 650-328-5016, or dreyes@nealemay.com, for Rentals.com

URL: http://www.prnewswire.com

LOAD-DATE: March 8, 2000

Evidentiary Exhibit Number 72

The Star-Ledger (Newark, New Jersey)
February 11, 2000 Friday
FINAL EDITION

SECTION: BUSINESS; Pg. 53
LENGTH: 959 words

HEADLINE: Cendant joins real estate agencies going *online*

BYLINE: Guy T. Baehr, Star-Ledger Staff

BODY:

The average American moves 13 times over a lifetime and, with the explosive growth of the *Internet*, one in four now logs onto the World Wide Web at least once in the process.

Sarah Nolan wants them all to log on to her new Web site - www.move.com - every time they even think about looking for a new house or apartment.

Nolan, as chief executive officer for the site, launched it into cyberspace this month for the Cendant Corp., the Parsippany-based franchiser of the Century 21, Coldwell Banker and ERA real estate brokerage brands.

Cendant also plans to launch its new subsidiary into the stock market later this year by issuing a series of common stock to track its performance. Cendant said yesterday that it will ask its stockholders to approve the plan when the company holds its annual meeting March 21 in East Hanover.

Of course, Cendant isn't the only corporate heavy-hitter going into cyberspace to reach some of the roughly 17 million Americans who move every year.

Microsoft Corp., the Redmond, Wash., software giant, already has its HomeAdvisor real estate site up and just signed an exclusive agreement with MoveCentral.com, a Boston-based company that provides *online* relocation services.

HomeAdvisor, along with two other established real estate sites, HomeSeekers and HomeStore.com, feature more home listings than move.com because they aren't limited only to properties listed by Cendant brokers.

Brad Inman, a veteran real estate columnist who jumped into the *online* world five years ago, said he doesn't think that puts Cendant at a disadvantage.

"This is a big category. Real estate is a trillion-dollar market with 5 million home sales a year and 900,000 real estate agents out there. It's way too early to declare one or two winners," Inman said.

"I welcome move.com," said Inman, who launched his own site (www.homegain.com) 10 months ago. "*Online* real estate is still in its infancy. The more innovations and new business models, the better."

Unlike move.com, Inman's site is narrowly focused on helping prospective home sellers find the most qualified sales agent. The Cendant site defines its mission much more broadly, he said, trying to help people with all aspects of moving.

Nolan said she's not worried about other sites having more listings because, long term, all real estate listings are likely to be posted on the Web for free. "What we're concentrating on is building a quality site that's complete and easy to use and that people will come back to every time they move," she said.

Instead of trying to be like those free real estate listing magazines you see at the supermarket, Cendant's is trying to take the stress out of the whole process of moving, she said.

Moving to a new home in a new locality is the third-most stressful life event - not as bad as the death of a loved one or divorce but worse than starting a new job or having a new baby - according to Nolan, who's moved five times in her 49 years.

"We spent many hours talking to people who were moving or had just moved, and we found there's a strong need for a one-source solution" to make the experience less daunting, she said during a "virtual press tour" of the site, which is based in San Francisco near Silicon Valley.

The site aims to make moving easier for consumers - letting them check out possible neighborhoods, see what's for rent or for sale, contact local brokers, fill out a rental application or apply for a mortgage, rent a van or contact a moving company.

It also offers plenty of advice and checklists to make the experience a bit more predictable and even lets them shop *online* for anything from a new sofa to a lawn mower.

The wholly owned subsidiary of Cendant also aims to deliver potential customers - first to Cendant's more than 200,000 brokers and sales agents and its mortgage company, Cendant Mortgage, and, second, to its "business partners," companies that are paying for a place on the new site.

These range from such traditional companies as Ryder, which rents vans and trucks, and Allstate, which sells insurance, to such other Web sites as rent.com (apartment rentals) and to such upstart "e- tailers" as hardware.com, furniture.com or Direct.com.

By Nolan's counting, people tend to spend 10 to 20 times more in the first three months after they move into a new home than a homeowner who's been settled in for at least five years would in that time. "It's a really rich demographic," she said.

Cendant has some formidable advantages as it tries to create what it hopes will be a real estate "mega-site."

For one thing, its franchised agents are already involved in about one out of every four home sales in the United States. For another, the 3-year-old company is a specialist in the kind of branding and cross- marketing that could make the site work. Cendant was formed in 1997 when HFC, a realty and hotel franchiser, merged with CUC International, direct marketing firm.

But it's not taking any chances. Cendant has agreed to pay Alta Vista $40 million to make move.com the exclusive real estate services channel for users of the popular *Internet* search engine and "portal."

Nolan, a former top executive at American Express, said she wants to make the new Web site into a significant money-maker for Cendant, but Ted Deutch, a spokesman for Cendant, said the stakes are even higher than that.

He said more and more people are going to the Web when they look for a new home and Cendant, which makes a big chunk of its profits from its real estate franchise, mortgage and corporate relocation businesses, "has to be there for them."

A survey by the National Association of Realtors last year found that 23 percent of all potential homebuyers have gone *online* to search for homes, up from about 2 percent in 1995.
LOAD-DATE: April 16, 2007

Evidentiary Exhibit Number 73

PR Newswire

January 19, 2000, Wednesday

SECTION: FINANCIAL NEWS

DISTRIBUTION: TO BUSINESS, REAL ESTATE AND TECHNOLOGY EDITORS

LENGTH: 742 words

HEADLINE: Realtor Magazine Looks at Selling Real Estate the 'E' Way

DATELINE: WASHINGTON, Jan. 19

BODY:

The efforts of a number of real estate and technology companies to create the *online* model for the complete electronic real estate transaction is examined in the February issue of Realtor Magazine, the official publication of the National Association of Realtors.

In "Selling the 'e' Way," author Marcie Geffner notes that consumers are learning about home buying and selling, previewing homes for sale, researching and comparing mortgage products, and submitting electronic loan applications through secured channels.

"The next great leap will be into web-based transaction platforms and networks that will facilitate *online* transaction management and electronic transaction closings," Geffner says.

In her article, Geffner examines what several of the country's largest firms are doing to capture the business of today's computer-savvy, *Internet*- using home buyers and sellers. The article explores the creation of *online* models for real estate transactions, including barriers that could block the success of complete e-transactions.

Several industry experts share their insights into the future of the electronic real estate transaction, including David Griffith, *Internet* business manager for The Corcoran Group in New York, N.Y.; and Richard Smith, chief executive officer of the Cendant Corporation's Real Estate Division in Parsippany, N.J.

Despite the impact technology has had on the real estate industry, many practitioners still question whether the real estate industry is prepared for consumers to buy and sell their homes through the *Internet*, Geffner writes.

According to the article, much of the skepticism lies with sales agents, not with the lack of technological capabilities.

"We've looked into systems that track transactions *online*, whereby a sales associate and a customer can work together *online*," Griffith says. "But, many of the salespeople aren't ready for it. Technologies are emerging that are making that a possibility, but salespeople still have some catching up to do," he adds.

According to Smith, the real estate industry is ready for the e- transaction. "We're certainly more capable as an industry of dealing with e- commerce than say, the stock brokerage industry, which was caught off guard," Smith says. "We're far better prepared for this than any other industry with which I'm familiar."

"Selling the 'e' Way" discusses concerns relating to the evolution of the e-transaction, including the need for real estate-specific transaction platforms, and networks that will fully enable *online* transaction management and the exchange of document information standards. Other issues include the validity of the digital signature and whether some *online* activities are in compliance with the Real Estate Settlement Procedures Act (RESPA).

Additionally, the e-transaction must have value for the consumer, the article states. "If the consumer sees *online* transactions -- or any use of technology -- as adding value to buying or selling homes, it will be a grand- slam home run," Smith says.

While no one can pinpoint when -- or if -- the full-fledged e-transaction will become commonplace in the real estate industry, the article's experts agree that the prerequisites are in place, and it is only a matter of time before technology meets consumer demand.

The February issue of Realtor Magazine also features "Click Here to Bid," an article that examines several dot-com companies that sell properties through *online* bidding. Also in the issue, "The 'Royalty' of Real Estate Sales" introduces readers to four "high-flying mavens" of real estate who specialize in selling luxury properties. These "elite" property specialists are from Chicago, Savannah, Ga.; Scottsdale, Ariz.; and Seattle.

The National Association of Realtors, "The Voice for Real Estate," is America's largest trade association, representing more than 750,000 members involved in all aspects of the residential and commercial real estate industries.

Information about NAR is available at http://nar.realtor.com. This and other news releases are posted in the Web site's "News for You" section, at http://nar.realtor.com/news.

SOURCE National Association of Realtors

CONTACT: Annemarie Roketenetz of National Association of Realtors, 202-383-7560 or email aroketenetz@realtors.org

URL: http://www.prnewswire.com

LOAD-DATE: January 20, 2000

Evidentiary Exhibit Number 74

Chicago Tribune

December 24, 1999 Friday, CHICAGOLAND FINAL EDITION

SECTION: YOUR PLACE; Pg. 8; ZONE: C; Resale Q&A.

LENGTH: 723 words

HEADLINE: *INTERNET* ONLY ADDS TO TRADITIONAL HOME BUYING

BYLINE: By Robert Bruss, Tribune Media Services.

BODY:

Q--A friend at work, who knows that my wife and I are looking for a home to purchase, suggested we start shopping on the *Internet*. We've been checking out homes listed at Realtor.com and other Web sites, but we're wondering if anyone really buys a home on the *Internet*.

We've contacted a few agents whose local listings interested us. Some never replied to our e-mail. Others got back to us within 24 hours. What do you think about shopping for a home on the *Internet*?

A--few weeks ago, I attended the Realtors' national convention in Orlando. More than 20,000 Realtors were there, and everyone was talking about how the *Internet* is affecting home sales.

After talking with Realtors from all over the nation, many of whom have their personal Web sites, I concluded the *Internet* is a great place to start your home shopping quest. It's a good way to learn what homes are for sale in the area, but there is no substitute for a personal home inspection tour. The *Internet* listings are also very incomplete, so don't depend on them to learn total home availability.

My personal experience in checking local *Internet* listings near where I live is that the information is often outdated. I found nearby residence listings with "sold" signs out front that are described on the *Internet* as active listings.

It won't do any harm to check the dozens of Web sites to see what homes are listed for sale in the neighborhoods that interest you. You will even find some fun listings that offer so-called "virtual tours" so you can see what the home's rooms look like. At this time, the *Internet* is just another place to search for a home, in addition to the traditional newspaper classified ads and getting out and driving neighborhoods that interest you.

Q--I am one of those horrible absentee landlords you sometimes mention. A relative is mismanaging my four-unit apartment building, which I bought when I lived in another city. I moved away about 12 years ago.

At a cocktail party, I recently met a local Realtor who suggested I make a Starker tax-deferred exchange for a rental property closer to my current residence. Is it really possible to avoid paying tax and acquire investment property near where I now live?

A--Yes. That Realtor you met is very astute. Most Realtors have no clue about Starker tax-deferred exchanges. But such trades are quite simple.

The first step is to sell your four-unit apartment building. Be sure the sales proceeds are held beyond your constructive receipt by a third-party accommodator or intermediary, such as a bank trust department or an exchange facilitator.

The second step is to designate to the intermediary the qualifying replacement property you want to acquire. A major drawback of Internal Revenue Code 1031(a)(3) is that you only have 45 days after the sale closes to

designate the replacement property. Because of this very short time, you should have the replacement property lined up before selling your apartment building. But you have up to 180 days after the sale to close the acquisition.

The third step is to close the purchase of the qualifying replacement investment or rental property. Be sure to consult a real estate tax adviser or attorney.

Q--Due to a sudden job change, we had to move from our old home quickly. We listed it for sale about two months ago with what we thought was a fine real estate agent. Since then, we rarely hear from him. I've phoned him to see what he's doing to get our house sold, but he takes several days to return my calls. He says the market is slow now in our price range. Our listing has four months remaining. How often should our listing agent contact us?

A--Shame on you for signing a six-month listing without a cancellation clause. Your listing agent should phone you at least once a week to inform you of marketing activity. Since you are out-of-town and signed a six-month listing, he is probably working on his other listings instead of yours.

I suggest you phone the agent's office manager to find out why your home hasn't sold or had any purchase offers. If necessary, insist your listing be transferred to a better agent with the same firm. Although this is the slowest time of the year for home sales, make it clear you expect marketing activity or you will cancel your listing for lack of due diligence.
Owning.
LOAD-DATE: December 24, 1999

Evidentiary Exhibit Number 75

The Washington Times
May 21, 1999, Friday, Final Edition
SECTION: PART F; FRIDAY HOME GUIDE; ON THE HOMEFRONT; Pg. F3
LENGTH: 887 words

HEADLINE: From using the *Internet* to auctioning a home
BYLINE: M. Anthony Carr; THE WASHINGTON TIMES
BODY:

I receive several questions from readers after each issue is published, but many of them are too specific to assist any other readers. Here are a few I thought most readers could find beneficial.

Q: I read the Friday Home Guide every week. It offers wonderful advice, has great articles and helpful neighborhood profiles. I'd like the to know if there is a way I can find out about homes that are foreclosures, lease options or fixer uppers via the *Internet*.

- E. Rodgers, via e-mail

A: Your best bet is to start with Realtor.com, the official Web site of the National Association of Realtors. At this location, you can search for all sorts of property. I did a quick search for "fixer uppers" in Herndon and the result was three properties.

Another Web site is operated by the Department of Housing and Urban Development, but the usual list of foreclosed properties is absent at this time as HUD is reorganizing how it sells the properties. The Web site is www.hud.org/dchud.

While the *Internet* is a powerful tool for real estate shoppers, keep in mind it is primarily a marketing tool for sales people. The day-to-day inventory system real estate professionals use to buy and sell houses is a much more effective means of finding the property you want. The only way to gain access to that system is by hiring a Realtor.

Q: I read an article in the Friday Home Guide about "auctioning" your home - and that it's not just for large estates anymore. About 1 1/2 years ago, I tried to sell my one-bedroom condo in Northeast D.C. I was looking for a larger place and had on separate occasions written contingency contracts on two homes I liked in Montgomery County.

Since I couldn't sell my current place, I lost them and I'm still here in my small condo. I don't want to keep it and rent it out. I don't have nor do I want to put a lot of money into it for selling. Auctioning seemed like a good idea for me at first blush, but who do I contact to find out more?

- via e-mail

A: That you have a condo is your first challenge. That it has one bedroom is your second challenge. (I feel your pain, as I have owned and rented out a condo myself.)

Your first step at auctioning would be to contact auction firms or real estate companies that maintain auction departments. Long & Foster has an auction department, as do other companies in the Washington area. Auction firms also can be found under "Auctioneers" in the Yellow Pages.

You might want to reconsider renting your property until the market picks up in your development. While there is a housing boom going on in the Washington market, that boom has passed by some submarkets - condominiums being one of them.

On the other hand, the good thing about a condo is you don't have the yard, roof, basement, etc., to worry about as a landlord. The rental market is tight right now, so you should have a good chance of renting it quickly. Depending on the basic condition of your unit, all you may need to get the unit ready for renting are a fresh coat of paint and shampooed carpet.

As you begin advertising the property, be sure to have the applicants checked out through a credit agency - or you could use a real estate company or mortgage lender.

The money you need for your personal buy-up may be easier to attain than you think. There are 100 percent financing programs available for buyers with good income and credit - so you could buy your next home with no down payment since you would not benefit from receiving the equity in your condominium.

Q: Recently, I was notified that the tax assessor had lowered the value of my home by $6,000. While I appreciate the drop in my real-estate taxes, I also wonder what, if anything, the lower figure does to the potential resale value of the house.

Furthermore, if you have kept up with repairs and done remodeling, how do assessors decide the current value? Does this mean area property values are going downhill?

- via e-mail

A: While assessors will contend their assessments are near market value, most Realtors will tell you otherwise. If you check the market value in the community, you will probably see the average sales prices in your community has also dropped. Assessments generally lag behind sale prices, however.

Nevertheless, the assessment could affect the way a real estate agent determines your asking price by using a formula where the average assessment value is divided by the average sales price in your area. The resulting number gives you the figure by which you would divide your specific assessment value to determine your asking price (which will most probably be near the actual sales price once you sell).

Here's how it works. If the average sales price in your community is $150,000 and the average assessment value is $130,000, then the formula you would use for your specific value would be .87 ($130,000 divided by $150,000). Therefore if your actual assessment is $132,000, divide it by .87 and you arrive at $151,724, which will probably be close to your actual sales price. So the list price should be set around $154,900.

Send your questions about buying or selling a home to M. Anthony Carr, Friday Home Guide, 3600 New York Ave. NE, Washington, D.C. 20002. Or send e-mail to carr@twtmail.com.
LOAD-DATE: May 21, 1999

Evidentiary Exhibit Number 76

Ventura County Star

June 15, 2001, Friday

KR-ACC-NO: VE-CONDOMINIUM
LENGTH: 642 words
HEADLINE: Real Estate Group Converting Mentor, Calif., Apartment Complex into Condos
BYLINE: By Dave Truman
BODY:

An uncommon transition is taking place on Center Street in Mentor.

Ag Real Estate Group Inc., a year-old Beachwood firm, has renamed the 30-year-old apartment complex at 6400 Center St. and is turning the townhouse rental units into condominiums.

Formerly known as Lafayette Villa, Heatherstone Condominiums is undergoing a $ 2 million renovation that could take three or four years, according to Ag Group President Eric M. Silver.

Bob Walick, president of the Cleveland Area Board of Realtors, said converting rental units to condominiums was last popular in the 1980s. A 1986 federal tax law revision made the switch less profitable and suitable property became scarce a few years later. "It tapered off in the '90s," Walick said. "Most of the good, solid units were gone." The key to a successful conversion usually is getting current tenants to buy, he added. Older, affluent tenants or others who are not likely to move -- such as those who have lived in one place for a long time -- generally make the best conversion buyers. Ag Group purchased the property in January for more than $ 6 million.

"Everything you can see and touch is new," Silver said of the renovated model.

The renovation includes all new windows, kitchens, bathrooms and ceramic tile floors.

Silver is in no hurry to complete the conversion and renovations because nearly all of the 148 units are occupied.

"It's all going to be sales driven," he said. "We'd like to sell out the first phase and begin the second phase sometime this year." Ag Group is doing its best to make tenants comfortable with the change, he said. They have each been offered the chance to buy their unit with a $ 3,000 incentive and all leases will be honored.

A two-bedroom townhouse with 1 1/2 baths sells for $ 92,950. Three types of three-bedroom units sell for between $ 102,950 and $ 104,950 based on location, and four-bedroom units with 2 1/2 baths sell for $ 112,950.

Upgrades are available in each unit, ranging from $ 225 for a microwave to $ 2,200 for a washer/dryer closet hookup.

According to Silver, the selling price could actually be a boon to tenants. Many of those who decide to buy would actually lower their monthly payments.

Tenants are paying between $ 700 and $ 960 per month in rent.

"With the interest rates where they are, it will actually be cheaper for them to buy," Silver said. "We have one under contract and a couple are exploring the possibilities of buying." Some residents have traded units to allow for renovations and a few have left Heatherstone.

"We are making an effort to have them understand what is going on and make them comfortable with it," Silver said. "The response from tenants has been very positive." The decision to choose the former Lafayette Villa property for Ag Group's first investment was a simple one, he said.

Silver knew city officials from previous projects he handled while with another company and the property was attractive because of its location and surrounding amenities.

"As we looked around Mentor, the immediate neighborhood has appreciated with the Fine Arts Center, City Hall, Civic Center, pools, the ice rink... It was time for what was known as Lafayette Villa to have a facelift," Silver said.

The income from leased units serves as a sort of safety net, allowing sales of units as condos to proceed over an extended period, he added.

"Obviously interest rates are working in our favor," Silver said. "There is some uncertainty in the economy right now, but we'll see what happens." Heatherstone's open houses are Saturdays and Sundays from 1 p.m. until 4 p.m.

For more information call Ag Group at (216) 504-5000.

JOURNAL-CODE: VE
LOAD-DATE: June 19, 2001

Evidentiary Exhibit Number 77

The Daily Record of Rochester (Rochester, NY)
May 15, 2001 Tuesday

SECTION: COMMENTARY
LENGTH: 329 words

HEADLINE: Commentary: How to avoid extra taxes when selling your house
BYLINE: Francis Marchese
BODY:

There aren't many ways to earn money without the government taking a tax bite. Selling your home can be one of the exceptions. If you meet certain requirements, you may qualify for up to $250,000 ($500,000 for married couples) of tax-free income every time you sell a home.

To exclude the full amount allowable from your income, you must own and occupy your home as your principal residence for at least two of the five years prior to its sale. Generally, you are only permitted to use this exclusion every two years. However, if you move sooner for health or job relocation reasons, a partial exclusion may apply.

You can also create tax-free income when you sell a rental or vacation home as long as you've owned and occupied it as your principal residence for the required amount of time before selling.

Let's look at a couple of examples:

* Example 1: You've owned a rental house for ten years. If you move into your rental house and live there for at least two years prior to its sale, you've just created tax-free income. You must pay tax on any depreciation taken after May 6, 1997, but the rest of the gain is tax-free, up to the allowable limits.

* Example 2: You purchased your first home in 1985. Three children later, you are ready to move to a bigger home. You decide to rent your old house. As long as it's not rented for more than three of the five years prior to its sale, you can still exclude the gain, up to the allowable limits. As in the prior example, you must pay tax on any post-May 6, 1997, depreciation.

A home office may create a tax deduction, but it can also present a tax trap. If you use a home office for more than three of the five years prior to your home's sale, the gain on the home office portion will be fully taxable.

Maximize your opportunities to create tax-free income when you sell your property.

Francis G. Marchese, CPA, operates an accounting practice in Chili. His internet address is at www.fgmcpa.com.

LOAD-DATE: May 26, 2005

Evidentiary Exhibit Number 78

The San Diego Union-Tribune

March 4, 2001, Sunday

SECTION: REAL ESTATE;Pg. I-8

LENGTH: 986 words

HEADLINE: Additional homes can mean savings

BYLINE: ROBERT J. BRUSS; Robert J. Bruss is a San Francisco lawyer, broker and nationally syndicated real estate writer. (C) Tribune Media Services

BODY:

If you own a vacation or second home, or are thinking about buying one, consider the income-tax savings during ownership and when you sell it.

Depending on your personal situation, you might be able to claim substantial tax deductions during ownership. When you decide to sell, you could possibly make a completely tax-free sale.

[] Keep careful tax records -- The key to maximizing your tax savings from a vacation or second home is keeping careful tax records, just in case the Internal Revenue Service audits your tax returns. If you document your entitlements, you'll save thousands of tax dollars. Without good records, especially regarding personal occupancy time, you could forfeit your vacation- or second-home tax breaks and incur a negligence penalty.

[] Is your second home your "main home" part of the year? -- Millions of snowbirds spend a major portion of each year living in their warm-climate second home, typically in Florida, Arizona, Hawaii or California, and then return to their other residence for the rest of the year.

Depending on the amount of time spent at each home, one or both might qualify for up to $250,000 home-sale tax-free profits if you should decide to sell. If you're married and both spouses meet the occupancy test, then up to $500,000 home-sale profits can be tax-free.

To qualify, Internal Revenue Code 121 requires ownership and occupancy of your "main home" an "aggregate" two years during the five years before the sale. Only one spouse need hold the title. But if both spouses claim the $250,000 exemptions, then both spouses must meet this occupancy test.

For example, suppose you live full time in your Florida home from November to April annually, but you move to your other home, full time, from May through October each year.

If you decide to sell either of these residences, both meet the aggregate two-year occupancy test. However, this tax break can only be used once every 24 months, with limited exceptions for job-location changes and health-related moves.

While not conclusive, evidence of "main home" occupancy includes such things as utility bills, voter and automobile registration, business or retirement income, and tax return filings while you are living there.

[] Claim vacation- or second-home tax benefits during ownership -- Although secondary residences usually aren't great tax shelters during ownership, they often provide significant tax savings. Here are the four possible situations:

No personal use time: If you never occupy your vacation or second home, except for minimal cleaning and repair time, and it is rented or available for rent the entire year, all the rental income and applicable expenses

must be reported on Schedule E of your income tax returns. Mortgage interest, property taxes, insurance premiums, utilities, repairs and depreciation can be subtracted from the rental income received.

You will probably have a tax loss if your second home falls in this category. But you must "materially participate" in managing your property.

You also must earn less than $100,000 adjusted gross income in 2000 if you are to claim up to $25,000 "passive activity" loss from your rental property against other ordinary, taxable income.

However, if you're a qualified real estate professional, such as a real estate broker, there's no limit to your deductions in this rental property classification.

Minimal or no rental time: If you rent your vacation or second home to paying guests fewer than 14 days per year (regardless of the amount of rent received), that rent need not be reported on your income tax returns. But you can fully deduct your mortgage interest, property taxes and any uninsured casualty loss (such as rain or snow damage) as itemized deductions on Schedule A of your income tax returns.

Annual personal use of more than 15 days or 10 percent of the rental days (if rented more than 14 days per year): If you or your relatives use your vacation or second home heavily in this category, you cannot deduct any loss from the property on your income tax returns. But mortgage interest and property taxes are always tax deductible.

For example, if you rented your ski cabin to tenants for 90 days in 2000, and personally used it for 20 days, then you fall into this category.

Schedule E is the place to report the rental income received and the applicable expenses. The correct order for deducting expenses is mortgage interest, property taxes, uninsured casualty losses, operating expenses and depreciation.

If mortgage interest, property taxes and uninsured casualty losses exceed the rent received, the excess expenses should be deducted as itemized deductions on Schedule A.

Annual personal use of fewer than 15 days or less than 10 percent of the rental days that exceed 14 rental days: In this category, if your personal use is fewer than 15 days a year or less than 10 percent of the rental days that exceed 14 days annually, there's no limit to your loss deductions (except for the $25,000 annual passive activity loss limit explained above).

For example, suppose you rented your summer home to tenants for 120 days last year, and personally used it only 10 days. Then you are in this category.

However, the IRS says the profit motive of Internal Revenue Code 183 applies, requiring a profit at least three out of every five years of your rental activities.

[] Summary -- Vacation and second homes are not great tax shelters during ownership. But they can provide modest tax savings during ownership while the property appreciates in market value. However, if you meet the "aggregate" ownership and occupancy tests for two out of the five years before sale, your sale can be tax-free up to $250,000 per qualified home seller. Please consult your tax adviser for complete details.

Next week: When your moving costs are tax deductible.

LOAD-DATE: March 5, 2001

Evidentiary Exhibit Number 79

Orlando Sentinel (Florida)

February 18, 2001 Sunday, METRO

SECTION: HOMES; Pg. J26

LENGTH: 552 words

HEADLINE: WHAT HAPPENS TO UNUSED REVERSE MORTGAGE CREDIT?

BYLINE: Robert Bruss, Tribune Media Services

BODY:

Question: I have a reverse mortgage with a line-of-credit plan. I had a mortgage balance that was paid off when I obtained my reverse mortgage credit line. I have not used any of my remaining credit line.

In a few years, if I decide to sell my home and still have not used the line of credit, what happens to it and the interest, which is accruing? Does the original line of credit revert back to me

Answer: For readers not familiar with reverse mortgages, they are available to homeowners at least 62 years old who own their houses or condominiums. They are the opposite of traditional mortgages where the homeowner borrows money secured by the residence and usually repays it to the lender over 30 years.

Instead, a reverse mortgage requires the lender to pay the homeowner, with no repayment required until the owner dies, permanently moves out of the residence or sells it. At that time, the reverse mortgage principal and accrued interest is paid off and the remaining home equity goes to the home seller or the heirs.

If you don't use your remaining reverse mortgage credit line, your balance will remain as it is today, plus accrued interest. You don't pay interest on the unused portion of your credit line.

RENTAL PROPERTY EXCHANGE

Q: A friend of mine owns a four-plex that he is willing to sell to me and carry back the mortgage. The problem is he has fully depreciated the building.

My friend's accountant says if he sells the building he will get killed on capital gains taxes. The CPA said a tax-deferred exchange won't work in this situation. The building is valued at $540,000 in a good area. How can I make this work so I can buy the building?

A: The only way to avoid tax on the sale of rental property is an IRC 1031 tax-deferred exchange. I don't understand why the CPA said it won't work. But your friend would then have to trade up to another investment property of equal or greater cost and equity.

However, because your friend is willing to finance your purchase and carry back the mortgage, that means he can qualify for installment sale reporting of his profit tax. That means he can spread the capital gains tax over the years of the installment mortgage, perhaps 20 or 30 years.

Your monthly payments to him will be partly nontaxable return of his capital investment, partly taxable capital gain and partly taxable interest.

SELLING AN INVESTMENT

Q: We own 16 rental houses. About half are free and clear. I am 73, but she is only 66. We're both retired, except for managing the rental houses, which produce great rental income.

Our son, age 34, wants to take over, but he doesn't have any money for even a down payment to buy his own house. He rents an apartment. However, we need the rental income from our houses to keep up our lifestyle and provide for our retirement. Do you think we should sell the houses to him if he could get financing?

A: Why not sell one of the free-and-clear houses to your son for nothing down and carry back the mortgage so you will continue to have income? Your son probably won't have much net rental income, but it will get him started in realty investing. Test him. If he does well, sell him more houses on the same terms. The result will be to lighten your management load and to show him the joys of investing in real estate.

COLUMN: Real Estate Mailbag

LOAD-DATE: February 18, 2001

Evidentiary Exhibit Number 80

The Washington Times
February 16, 2001, Friday, Final Edition
SECTION: PART F; FRIDAY HOME GUIDE; MOVING UP; Pg. F28
LENGTH: 1745 words

HEADLINE: Seller's market has homeowners eyeing move up

BYLINE: Michele Lerner; SPECIAL TO THE WASHINGTON TIMES

BODY:

A growing number of homeowners in the Washington area are becoming aware that home values have risen and therefore they have more equity in their homes than they had anticipated. That extra equity sometimes provides the impetus for owners to sell their homes and move up to a larger home or to a residence in a different neighborhood.

Owners decide the time is right to put their home on the market for a variety of reasons, including a growing family, a shrinking family, lower interest rates or an increased income that makes a larger mortgage payment more affordable.

In a seller's market such as the current situation in the Washington area, homeowners can be tempted to put their homes on the market because they hope it will sell as quickly as have some neighboring properties.

"Selling your home is easy in this market," says Carol Greco, associate broker with Long & Foster Real Estate in Annandale. "The bigger problem is finding a home to buy. If you put your home on the market, even with a 60-day closing, you might not be able to find a great house."

The first step to moving up to a new home is the same step that first-time buyers must take: obtaining a pre-approval for a mortgage from a lender. In a seller's market, virtually all buyers must have a pre-approval for a loan when they make an offer, or that offer will be rejected in favor of a buyer with a firm commitment for a loan.

"Getting a pre-approval first helps a seller determine their buying power whether they sell their home or decide to keep their first home and rent it to a tenant," says Brad Carter, regional director for Weichert Financial Services.

"Part of the approval process when you are selling a home will depend on the lender doing a market analysis of the value of your home. The lender will look at comparable homes in your neighborhood, similar to an appraisal to determine the value of your home, then take out 6 percent of that for the anticipated Realtor's commission, subtract the amount still due on your mortgage, then determine the amount of equity left in the property."

Sellers need to have their own loan pre-approval in place before they put their homes on the market or begin to look for a property to buy, and they need to make sure the buyers of their home also have been pre-approved.

"When people buy a home today, it's like going to war, and good soldiers are always prepared before going into a war," Mrs. Greco says. "Sellers need to be prepared with a loan approval and an appraisal. They should

also get lenders' letters on their buyers and on their buyers' buyers to make sure that their sale will go through too."

Once the pre-approval process is complete, sellers may think it is time to put their home on the market - but a prudent seller will take a few more steps before putting up that for-sale sign.

"As soon as someone has their pre-approval and we know about what they can afford to spend, it's important to take them around to look for homes," says Barbara Zuckerman, a Realtor with Long & Foster Real Estate in the District.

"If people are flexible and willing to look at different neighborhoods or away from a Metro stop, we can find something. Buyers with less flexibility are having a harder time finding a home. But it's important that before someone puts their home on the market they have an idea of what's available, which will help them decide if they even really want to sell their home.

"I'm showing them around so that they know they'll find something if they do decide to sell," she says. "Homes sell so quickly now that buyers need to be ready to make an offer immediately when they find something they want, and that offer needs to have no financial contingencies at all, including the sale of a home. Some people today are even making offers without including a home-inspection contingency, but I think everyone should have a home inspection. I refuse to take responsibility for anyone who does that."

It is standard practice for most people to work with the same real estate agent when selling one home and buying another, unless the seller is moving out of the area. Many agents in this area are licensed in the District, Maryland and Virginia, so moving across borders in this region should not be a problem.

"The advantage of working with one Realtor for both transactions is that the Realtor and the seller understand each other and have developed a relationship," says Rosie Harsch, a Realtor with Long & Foster Real Estate in Vienna. "Your Realtor knows what you want and can help develop a situation to work out what's best for your circumstances."

The consensus is that move-up buyers today must sell their homes before making an offer on the home they want to buy, unless, of course, they can afford to own two homes at once, which some people can do.

"If a buyer has to sell their home in order to purchase another, then they need to write into their sales contract what's called a 'rent-back agreement,' which allows them to rent their home from the new buyer after settlement for a specified period of time," Mrs. Greco says. "This gives people some extra flexibility."

Mrs. Harsch says once your home is sold, your options are either to rent back from the new owner, move into a temporary rental or, ideally, move into your next home.

"The main issue as a seller is to get a good contract with patient buyers," Mrs. Harsch says. "If you want to buy a new home, the situation is even more intricate, because new homes are taking eight to even 12 months to be completed.

"If you do have to rent back your home or move into a temporary rental, it's important to understand the costs of this. Not only do you have to pay the rent for six months or however long it takes, but you also should be aware of the consequences of losing the tax benefits of paying a mortgage for those months.

"If you are making a profit of $100,000 on the sale of your home and the rent and tax costs will be $20,000, then it's probably worth making the move. But if your profit is a lot less than that, you need to decide if the move is worth the cost."

Financially, many area homeowners have enjoyed the benefits of special loan or tax programs for first-time buyers. Such programs are not available to move-up buyers, but a wide variety of loan possibilities and lower interest rates are adding incentives to the move-up market.

"When the interest rates drop, we begin marketing to our previous clients who might be in a town home or a smaller single-family home, reminding them that they can move into a single-family home or a larger home while making a similar mortgage payment to the one they make now," Mr. Carter says.

"Right now, a popular option is to do what we call an 80-10-10 loan or an 80-15-5 loan, which allows buyers to bypass paying private mortgage insurance. Buyers can qualify for an 80 percent first trust, a 10 or 15 percent second trust, and then put only 5 or 10 percent down."

"The key to figuring out which loan options work best for you is to anticipate how long you will stay in a house," Mr. Carter says. "The average family stays in a home for 5 to 6 years, so if that's what you expect to do, an adjustable-rate mortgage which stays steady for five to seven years makes sense. You can buy more house if the payment is lower, and with these loans, you are paying 3/8 to percent less interest. There's no risk to this if you anticipate staying only five to six years."

"Other loan options a lot of people are unaware of include a 40-year amortization, which makes home buying even more affordable since the monthly payments are lower," Mr. Carter says.

"The first few years of a loan, the payments are almost entirely interest anyway, so again, this type of loan makes sense if you are staying in the home a short time. Many people think fixed-rate loans are available only for 30 years or 15 years, but you can get them for 20 or 25 years if you want. The 15-year loan will have higher monthly payments, but it has the advantage of building home equity more quickly than the longer loan programs."

Move-up buyers who have been pre-approved for a loan, have decided what type of loan fits their financial circumstances and have sold their home with a rent-back agreement are ready to switch into the buying mode.

"Move-up buyers are looking for different types of houses according to why they are moving," Mrs. Zuckerman says. "Sometimes they have kids and need a larger home, but a lot of others are just moving up to another level of housing.

"If they have a house worth $600,000 to $800,000, they often want to move up to a $900,000 to $1 million home. A lot of buyers looking for larger homes are willing to buy a home they like and then do additions, adding a family room or a larger master suite. If they can afford to, some of these buyers will hold onto their current home, buy another house and wait to move until the remodeling is done."

Mrs. Greco says, "Some move-up buyers really are moving to more expensive homes, but they are not necessarily larger. It depends on the clients. Many empty-nesters are moving into a smaller home with a first-floor master suite or a condo in the sky somewhere so they don't have to take care of the yard. Some people are making lateral moves to just switch from one neighborhood to the next."

"Sometimes people want to stay in the same neighborhood and just move into a larger house with a bigger yard," Mrs. Harsch says, "but lots of other people are shopping all over the place. For instance, if a buyer is looking in the $500,000 range in Virginia, they will look at Vienna, Oakton, Reston, Great Falls, McLean and Chantilly.

"You've got your hands full if you also want to be near a Metro stop, because now even tear-downs are priced at $400,000 or $500,000 for the lot alone near Metro.

"People who want newer homes are moving out to Loudoun and Prince William counties, and I've had some folks tell me they are willing to commute 1 to 2 hours each way in order to live in a newer and bigger house. People working in the Dulles corridor have it easier, since they can live in Loudoun County without having a long commute."

Mrs. Harsch offers some advice for consumers during the move-up process: "Just be patient and try to have a sense of humor. Buying a new house can be fun. But most of all, stay focused on the long-term goal."
GRAPHIC: Illustration, NO CAPTION
LOAD-DATE: February 16, 2001

Evidentiary Exhibit Number 81

Orlando Sentinel (Florida)
February 11, 2001 Sunday, METRO

SECTION: HOMES; Pg. J13
LENGTH: 942 words

HEADLINE: REALIZE SAVINGS FROM 2ND HOME;
TAKE A TIP FROM MILLIONS OF SNOWBIRDS: KEEP ACCURATE RECORDS ON YOUR VACATION GETAWAY OR RENTAL HOUSE AND YOU'LL COME OUT AHEAD WHEN TAX TIME ROLLS AROUND.

BYLINE: Robert Bruss, Tribune Media Services

BODY:

If you own a vacation or second home, or are thinking about buying one, consider the income-tax savings during ownership and when you sell it. Depending on your personal situation, you might be able to claim substantial tax deductions during ownership. When you decide to sell, you could possibly make a completely tax-free sale.

The key to maximizing your tax savings from a vacation or second home is keeping careful tax records, just in case the Internal Revenue Service audits your tax returns. If you document your entitlements, you'll save thousands of tax dollars. Without good records, especially regarding personal occupancy time, you could forfeit your vacation or second-home tax breaks and incur a negligence penalty.

Millions of snowbirds spend a major portion of each year living in their warm-climate second home, typically in Florida, Arizona, Hawaii or California, and then return to their other residence for the rest of the year.

Depending on the amount of time spent at each home, one or both might qualify for up to $250,000 home-sale tax-free profits if you should decide to sell. If you're married and both spouses meet the occupancy test, then up to $500,000 home-sale profits can be tax-free.

To qualify, Internal Revenue Code 121 requires ownership and occupancy of your "main home" an "aggregate" two years during the five years before the sale. Only one spouse need hold the title. But if both spouses claim the $250,000 exemptions, then both spouses must meet this occupancy test.

For example, suppose you live full time in your Florida home from November to April annually, but you move to your other home, full time, from May through October each year. If you decide to sell either of these residences, both meet the aggregate two-year occupancy test. However, this tax break can be used only once every 24 months, with limited exceptions for job-location changes and health-related moves.

While not conclusive, evidence of "main home" occupancy includes such things as utility bills, voter and automobile registration, business or retirement income, and tax return filings while you are living there.

Although secondary residences usually aren't great tax shelters during ownership, they often can provide significant tax savings for homeowners. Here are four possible situations that may mean savings.

NO PERSONAL USE TIME

If you never occupy your vacation or second home, except for minimal cleaning and repair time, and it is rented or available for rent the entire year, all the rental income and applicable expenses must be reported on Schedule E of your income tax returns.

Mortgage interest, property taxes, insurance premiums, utilities, repairs and depreciation can all be subtracted from rental income that is received.

You will probably have a tax loss if your second home falls in this category. But you must "materially participate" in managing your property. You also must earn less than $100,000 adjusted gross income in 2000 if you are to claim up to $25,000 "passive activity" loss from your rental property against other ordinary, taxable income. However, if you're a qualified real estate professional, such as a real estate broker, there's no limit to your deductions in this rental property classification.

MINIMAL OR NO RENTAL TIME

If you rent your vacation or second home to paying guests fewer than 14 days per year (regardless of the amount of rent received), that rent need not be reported on your income tax returns. But you can fully deduct your mortgage interest, property taxes and any uninsured casualty loss (such as rain or snow damage) as itemized deductions on Schedule A of your income tax returns.

ANNUAL PERSONAL USE OF MORE THAN 15 DAYS

If you or your relatives use your vacation or second home more than 15 days or 10 percent of the rental days, if rented more than 14 days per year, you cannot deduct any loss from the property on your income tax returns. But mortgage interest and property taxes are always tax deductible.

For example, if you rented your ski cabin to tenants for 90 days in 2000, and personally used it for 20 days, then you fall into this category.

Schedule E is the place to report the rental income received and the applicable expenses. The correct order for deducting expenses is mortgage interest, property taxes, uninsured casualty losses, operating expenses and depreciation. If mortgage interest, property taxes and uninsured casualty losses exceed the rent received, the excess expenses should be deducted as itemized deductions on Schedule A.

ANNUAL PERSONAL USE OF FEWER THAN 15 DAYS

If your personal use is fewer than 15 days a year or less than 10 percent of the rental days that exceed 14 days annually, there's no limit to your loss deductions (except for the $25,000 annual passive activity loss limit explained earlier).

For example, suppose you rented your summer home to tenants for 120 days last year and personally used it only 10 days. Then you are in this category. However, the Internal Revenue Service says the profit motive of Internal Revenue Code 183 applies, requiring a profit at least three out of every five years of your rental activities.

Vacation and second homes are not great tax shelters during ownership. But they can provide modest tax savings during ownership while the property appreciates in market value. However, if you meet the "aggregate" ownership and occupancy tests for two out of the five years before sale, your sale can be tax-free up to $250,000 per qualified home seller. Please consult your tax adviser for complete details.

Next: When your moving costs are tax deductible.
COLUMN: Realty Tax Tips

LOAD-DATE: February 11, 2001

Evidentiary Exhibit Number 82

The New York Times
January 7, 2001 Sunday
Late Edition - Final
SECTION: Section 11; Column 1; Real Estate Desk; Pg. 6
LENGTH: 556 words

HEADLINE: Q. & A.;
For Sale: Stabilized Rental Unit
BODY:

Q During the apartment conversion craze in the 1980's, I bought two occupied apartments in Queens. Both are rent-stabilized, and the occupants pay their rent to me. As my children are now ready to attend college, I need to sell these units to help to pay tuition. The occupants are not ready to move since the rents are low compared with others in the area. What would be the most prudent course to take to sell these apartments? . . . Garry O. Kosteck, Dunellen, N.J.
A David Goldsmith, director of marketing for DG Neary Realty in Manhattan, said it is generally difficult for the owner to sell a rent-stabilized apartment while the legal tenant still occupies it. That is because such tenants -- and their legal successors -- have the right to remain for as long as they continue to pay the rents.

Investors who do buy occupied apartments normally prefer they produce at least enough rental income to offset the monthly maintenance charges. But even then, Mr. Goldsmith said, an occupied rent-stabilized apartment would most likely sell for only a fraction of the value it would have if it were not subject to rent regulations.

In addition, he said, investors who buy occupied apartments generally prefer to buy large blocks of them in the same building.

"Large blocks are easier to manage," he said. "If you buy a block of 100 apartments, you can hire a manager to manage them. If you buy two apartments, you probably have to manage them yourself."

Accordingly, Mr. Goldsmith said, it is unlikely that any broker would be able to market the apartments effectively for anywhere near the price they would demand if they were unoccupied.

One possible strategy, Mr. Goldsmith said, would be to offer to sell the apartments to their current occupants. Because the tenants could then sell them for market value, they might be willing to cooperate.

Another possibility, Mr. Goldsmith said, would be to offer the tenants a cash incentive to move out voluntarily. If that strategy is successful, he said, the apartments can then be sold for market value and the owner will lose only the money he pays the tenants to leave.
Tenant Is Seeking To Install Windows
Q I have a rent-stabilized apartment and would like to install my own new windows. If the building's owner decides to put new windows in all the apartments within the next few years, would he have the right to raise my rent for improvements even though I have already installed windows myself? . . . Marsha Green, Manhattan
A Daniel Finkelstein, a Manhattan lawyer who specializes in landlord-tenant law, said no tenant should ever install exterior windows in an apartment without the landlord's consent.

"It's grounds for eviction," Mr. Finkelstein said, adding that such action could also expose both the tenant and the owner to a significant risk of liability if someone was injured while workers were installing the windows.

Moreover, Mr. Finkelstein said, if the tenant somehow managed to install windows without the landlord's knowledge, the landlord could indeed obtain a rent increase if new windows were later installed throughout the building.

"He can take out the tenant's brand new windows, put in his own and then obtain a capital improvement increase," he said, adding that such an increase generally added one-fortieth of the cost of the improvement to the tenant's base rent.

URL: http://www.nytimes.com

LOAD-DATE: January 7, 2001

Evidentiary Exhibit Number 83

Chicago Tribune

December 23, 2000 Saturday, CHICAGOLAND FINAL EDITION

SECTION: New Homes; Pg. 2; ZONE: W; Realty Q&A.

LENGTH: 1533 words

HEADLINE: KEEP INFORMED;

TITLE INSURANCE PROTECTS HOMEOWNER IN CASE OF MECHANICS' LIEN

BYLINE: By Robert J. Bruss, Tribune Media Services.

BODY:

Q--On Sept. 1, we closed the purchase of our brand-new home. We obtained a Countrywide mortgage and a title policy from First American Title Insurance. On Oct. 10, we received a mechanics' lien notice for "labor, services, material, machinery and fixtures." The claimant was hired by our home builder. What action should we take? Do we need a lawyer? The title company says they will resolve the matter. Can I trust them to take care of this lien, since we don't want to lose our new home?

A--Your situation is a classic example of why every property purchaser should insist on an owner's title insurance policy. One of the major title insurance coverages is for mechanics' lien risks, such as the one you describe.

Your home builder apparently didn't pay a subcontractor or material supplier, who is entitled to record a mechanics' lien against your home on which work, services or materials were provided. Usually, recording the mechanics' lien is sufficient to motivate payment or settlement of the dispute.

However, if the property owner doesn't pay or settle, the mechanics' lien claimant can foreclose and acquire title to your home. But that rarely happens. Since you have title insurance, which your mortgage lender required, the title insurance company is liable to settle or pay the mechanics' lien so you won't lose your home and the lender's mortgage won't be eliminated if the claimant forecloses.

My suggestion is to write a polite letter to your title insurer, asking to be kept informed of the details resolving this dispute with the claimant. Find out who is handling the claim for the title insurer and phone that person every two weeks if you're not kept informed.

Title insurers resolve mechanics' lien problems every day. But it's best to be "pro-active" just to be sure this mechanics' lien doesn't get foreclosed by the claimant. If unresolved problems develop, you might need to hire an attorney who specializes in title insurance, but that is unlikely to happen.

Q--Can we give our home to our son with the right for us to continue living in the residence until our deaths or until we can no longer live in it? Can we also do this with our vacation home? If we can do this, how should we word the deed?

A--You can quit claim both property titles to your son, reserving life estates in each property. But why would you want to do that?

There are many drawbacks to giving away your real estate, even if you and your husband retain life estates. Your son would take over your low adjusted cost basis. That means when he eventually sells the properties, he will probably have to pay a large capital gain tax. Also, you and your husband will likely have to pay gift tax liabilities now.

Another drawback is you won't be able to sell those properties if you need cash.

Letting your son inherit the properties would be far better. Then he can get a new cost basis stepped-up to market value on the date of death. Please consult your tax adviser and attorney to discuss the adverse consequences.

Q-- We are having a major problem with too many renters in our 64-unit condo building. At the moment, we have 24 rentals. Not only are some of these renters noisy and troublesome, but owners who want to sell their condos are having great difficulty. Mortgage lenders won't approve loans because of the high 38 percent rentals. What can we do?

A--As the owner of a condo second home, I know condos can be great owner-occupied residences. However, absentee landlords and condo renters don't have the same interest in keeping up the condo complex as do owner-occupants.

The high 38 percent of condos being occupied by renters indicates something must be wrong. Why don't the owners want to live in the complex? If the drawbacks, perhaps poor maintenance or a bad management company, can be corrected to attract more owner-occupants, that will help .

The condo complex where I own a unit has a bylaw that a condo cannot be rented more than 12 months without approval of the board of directors. The result is owners who must move out, usually due to declining health, decide to sell rather than rent their condos. Thankfully, the complex is well-maintained with a waiting list of buyers.

My advice is to consult local condo management firms for their advice. Maybe your complex needs new professional management.

Q--I am a single, African-American mother of two, whose brother is willing to use his VA mortgage entitlement to help me purchase my first home. Is this possible? How can we do this?

A--Veterans Administration home loans require owner-occupancy. Unless your brother is part of your household and will be living in the home, he cannot use his VA mortgage entitlement to help you buy a home.

However, there are now several no and low down payment home mortgage purchase programs if you have good credit and good income. Consult a local mortgage broker who will take time to discuss FHA, PMI (private mortgage insurance), Fannie Mae, Freddie Mac and other low-cash home purchase plans.

Q--I understand I can make a tax-deferred exchange of an unimproved lot for a single-family house of equal or greater cost. To qualify for the tax-deferral, must I rent the house to tenants immediately after purchase, or can I occupy it for a few years and then rent it at a later time? My question occurs because mortgage lenders in my area want about 1.5 percent higher interest on rental property than for owner-occupied houses. I can't find anything in Internal Revenue Code 1031 about this.

A--Internal Revenue Code 1031 requires all properties in a tax-deferred exchange to be held for investment or use in a trade or business. These are called "like kind" properties. In the example you gave of trading a vacant lot for a house, that house must be rented to tenants. If you occupy it as your personal residence, it is "unlike kind" property and disqualifies the tax-deferred exchange.

Q--We recently moved out of our home of many years and moved into a new home we purchased. Our former residence is now rented to tenants. When we recently consulted our tax adviser, he said that by moving out of our old home, we lost out on that $250,000 home sale tax exemption if we decide to sell that house. Is this true?

A--No. Your tax adviser is wrong. Fire him! Hire a better tax adviser who understands Internal Revenue Code 121.

It simply says that a principal residence seller is entitled to claim up to $250,000 tax-free sale profits (up to $500,000 for a married couple filing jointly) if the home has been owned and occupied by the seller an "aggregate" of two of the last five years before the sale.

That means you can rent your former principal residence up to three years before selling it and still claim the $250,000/$500,000 tax exemption. That's because you owned and occupied it the previous two years. For more details, please consult a new tax adviser.

Q--About 20 years ago, my wife and I bought five rental condos in a small town. Today, they are worth about $40,000 each. I am now 74, and my wife is 68. These investments have been very good to us. We plan to keep them as long as we live. What is the best way to transfer these condos to our four children after our deaths and pay the least amount of taxes?

A--My recommendation is to hold the titles to those condos, as well as your home and other major assets, in a living trust.

The primary living trust purpose is to avoid probate costs and delays. A secondary advantage occurs if you or your wife becomes incompetent; then the other spouse (co-trustee) can manage the living trust assets, such as those condos, including sale or refinancing. The living trust can name your four children as beneficiaries after you and your wife die.

As you may know, when one spouse dies, the value of all assets left to a surviving spouse is free of federal estate taxes. This is the marital exemption.

When the second spouse dies, Uncle Sam will be waiting to impose federal estate tax on any net assets exceeding the $675,000 exemption. This estate tax exemption gradually increases to $1 million over the next few years. If your estate value exceeds $675,000 for each spouse, then you should consider an A-B Trust to double the exemption. Please consult an estate planning attorney for exact details.

Q--About seven months ago, we bought our home. We hired a professional inspector. He gave us a detailed, written report, but it neglected to disclose the roof is sagging from the weight of four layers of shingles.

When we had a minor roof leak recently, the roofer said our roof is in danger of collapse due to the age of the rafters and the heavy weight. Shouldn't the inspector have noticed this?

A-- Yes. However, getting the inspection firm to admit liability and pay at least part of the cost of removing the old roofs and installing a new one won't be easy. Please consult a local real estate attorney for more details.

PLEASE NOTE: Real estate laws vary from place to place. Be sure to check the laws of your state and municipality before making decisions on real estate matters.

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International Briefing

December 15, 2000

SECTION: LEGISLATION & REGULATION

LENGTH: 5881 words

HEADLINE: Allocation of Basis in Common Improvements After the Tax Court's 'Norwest' Decision - Roberts & Holland

SOURCE: Roberts & Holland, United States

BODY:

Should it matter whether a common improvement was undertaken to improve sales or to enhance a property's ability to generate rental income? The Tax Court apparently thought it did matter, in examining the precedents known as the "developer line of cases." Although Norwest failed, similarly situated taxpayers might avoid a similar result by selling the improvement along with the adjoining property, or properly accounting for any easements or other transferred rights.

A recent decision of the Tax Court provides an opportunity to reexamine the rule that the cost of a common improvement incurred by a developer may in certain cases be allocated to the basis of the properties benefiting from the common improvement. In Norwest Corp.,1 the Court reached a result that probably is correct, but did so in a manner that raises some troubling questions regarding the proper treatment of costs incurred to construct a common improvement.

The Atrium

The taxpayer in Norwest was the successor to United Banks of Colorado, Inc., the common parent of an affiliated group of corporations (collectively, the "Bank"). Throughout the years at issue and for some time prior thereto, the Bank owned a 22-story office building in downtown Denver (2UBC). The Bank also owned another, four-story office building (3UBC) located on the same block as 2UBC, and a third building ("Motorbank I") on an adjacent block. 2UBC was primarily leased to non-Bank tenants, while 3UBC was wholly occupied by the Bank, serving as its headquarters until 1983. Motorbank I housed a parking garage as well as two floors of office space.

In the late 1970s the Bank was in need of additional space and was planning the development of a new office tower (1UBC) to be located on the same block as Motorbank I, directly across from 2UBC. In connection with the design of 1UBC, the architects proposed the construction of an enclosed glass structure (the "Atrium") in the area between 2UBC and 3UBC and an elevated, enclosed pedestrian walkway (the "Skyway") to connect the Atrium to 1UBC.

The Atrium and the Skyway were intended to meet several objectives. First, the Bank wanted to connect 1UBC to its existing properties, which were located on Broadway in Denver's central business district. The location upon which 1UBC was to be built, although only a short distance away, was on the fringe of the central business district. The Atrium and Skyway would link 1UBC to the existing properties and place the "front door" to 1UBC on Broadway. Second, the Atrium would unify the Bank's properties as a single "center" and increase rental rates for 2UBC and 3UBC. Initial projections prepared for the Bank showed that the creation of the center would increase the values of 2UBC and 3UBC by approximately $9 million. Third, the center would have a distinctive shape that would create a strong identity in the minds of potential customers of the Bank. The Bank expected that the creation of the center would enhance the image of the Bank and would enable it to increase its market share.

The development plan, which included construction of the Atrium, was approved by a special committee of the Bank's Board of Directors on September 8, 1980. During the next several years, the Bank entered into a series of transactions involving the Denver properties. On February 5, 1981, the Bank granted a 70 -year lease (the "Ground Lease") to a partnership (the "1700 Partnership") apparently affiliated with the developer previously selected by the Bank.2 The 1700 Partnership agreed to construct 1UBC, and a parking garage on an adjacent block, and to pay the Bank both a fixed rent and a rent based on the net cash flow generated by 1UBC and the garage. The construction of 1UBC and the garage was completed in 1983.

Concurrently with the execution of the Ground Lease, the Bank entered into another agreement with the 1700 Partnership whereby the Bank, at its sole expense, would construct the Atrium. The agreement stated that the Atrium and the Skyway were being built to integrate 1UBC with the existing Bank properties, and that the 1700 Partnership and the developer would not have agreed to build 1UBC if the Bank had not committed to building the Atrium. At the same time, the 1700 Partnership agreed to construct the Skyway, with the costs of construction and maintenance to be shared equally by the Bank and the 1700 Partnership. The Bank granted to the 1700 Partnership, and to the current and future fee owners of the 1UBC land and improvements, an easement for pedestrian access through the common areas of the Bank's property, including the Atrium. The 1700 Partnership granted to the Bank an easement for pedestrian access through the common areas of 1UBC. Concurrently with the execution of the Ground Lease and the related agreements, the Bank also agreed to lease from the 1700 Partnership approximately 500,000 square feet of space in 1UBC.

The Bank retained two consulting firms in 1984, prior to construction of the Atrium, to evaluate the Bank's real estate holdings and to make recommendations regarding the possible sale of properties. Both these reports concluded that the increase in the rental value of the adjoining properties did not justify the cost of constructing the Atrium, which was estimated at that time to be $25 million. The reports also suggested that the Bank should not build the Atrium unless it was obligated to do so, and that the Bank consider whether it could avoid that obligation for an amount less than the excess of the $25 million estimated cost over the present value of the projected net cash flow from the Atrium ($2.7 million). Both consultants also suggested, however, that the Bank take into account the "recognition" value and enhancement of image anticipated from the Atrium. Shortly after receiving these reports, the Bank decided to offer 2UBC and the Ground Lease (relating to 1UBC) for sale, but also decided to proceed with the Atrium (for reasons noted below). Construction of the Atrium commenced in 1985 and was completed in 1987, with the Atrium structure being placed in service in 1986. The total cost of the Atrium, Skyway, and related equipment, furniture and fixtures through 1987 was approximately $34 million. The Bank owned and operated a cafe in the Atrium, leased the retail space in the Atrium to a convenience store, and leased the other space for "espresso carts." The revenue from these operations was not sufficient to cover the operating expenses relating to the Atrium, and the Bank incurred operating losses of $493,000 in 1989 and in excess of $500,000 per year in each of the succeeding years.

In the meantime, however, the Bank had sold 2UBC and a 50% interest in Motorbank I in 1985 for $35.5 million. It agreed to complete the construction of the Atrium and the Skyway and to maintain them and certain other nearby improvements at the Bank's sole expense, for 35 years, with a right to terminate the Bank's obligations relating to the Atrium after 15 years upon payment of a termination fee to the purchaser.3 The Bank and the purchaser also granted to each other reciprocal easements pertaining to ingress and egress of pedestrians through common areas, including the Atrium. The Bank recognized a substantial gain on the sale of these properties.

In the view of the court, this sale meant that the Bank would not enjoy most of the increase in the value of the adjoining properties that was projected to occur as a result of the construction of the Atrium. The Bank nevertheless decided to proceed with the construction of the Atrium because (1) management believed the

Atrium would enhance the Bank's image (it retained a major presence in 1UBC), and (2) the Bank estimated that it would cost at least $16 million to avoid its obligations under the Ground Lease to build the Atrium.

In a series of transactions pursuant to agreements dated December 31, 1987, the Bank sold the 3UBC building to the law firm that was the Bank's legal counsel, for a nonrecourse note, and leased the land underlying 3UBC to the law firm for a term of approximately 35 years. At the same time, the Bank leased back all of the space in 3UBC pursuant to a lease under which the Bank agreed to operate the building, insure it, and replace the building if destroyed. The Bank treated the transaction as a sale of 3UBC, and reported a substantial gain on the sale in 1988 under the installment method. The Bank and the law firm granted each other reciprocal easements of access, and the Bank also agreed to maintain the Atrium (presumably for the term of the 3UBC ground lease).

By agreement dated December 30, 1988, the Bank sold the land underlying 1UBC together with its interest in the Ground Lease (relating to 1UBC). The Bank reported a capital loss on that sale.

Also on December 30, 1988, the Bank sold an undivided 48% interest in the Atrium for a promissory note of $17.1 million. Contemporaneously, the buyer contributed the interest in the Atrium to a newly formed partnership of which the Bank was the general partner, and the partnership and the Bank leased their interests in the Atrium to a Bank entity for a term of 30-1/2 years, with declining rent of approximately $38 million in the aggregate payable to the partnership with respect to its 48% interest. The sales agreement obligated the seller and buyer of the 48% interest and the tenant to report the transactions for income tax purposes as a sale and a lease. In its 1988 federal income tax return, the Bank reported a gain on the sale of the 48% interest in the Atrium and Skyway, and the Bank as tenant under the lease claimed deductions for rent in 1989 and succeeding years.

In determining its basis in 2UBC, Motorbank I, 3UBC and the land underlying 1UBC, the Bank did not initially allocate any part of the cost of the Atrium to these properties. The Bank first claimed that it was entitled to allocate the cost of the Atrium to the bases of adjoining properties in 1992, in a letter to the IRS appeals division, presumably sent after or in the course of an audit. This issue was one among several that ended up before the Tax Court, where the IRS sought to sustain asserted tax deficiencies for various years ranging from 1977 to 1991 and the Bank alleged overpayments in the same years.

The Bank's Arguments

Norwest argued that the cost of the Atrium should be allocated among the bases of the properties that adjoined and benefited from it, because the purpose of the Bank in constructing the Atrium was to enhance the values of those properties. Although the Bank's tax returns reflected a sale of a 48% interest in the Atrium in 1988, it appears that by allocating the cost of the Atrium to the bases of the adjoining properties the Bank was attempting to recover the remaining 52% of its basis in the Atrium, and perhaps attempting to shift a portion of the basis recovery from 1988 back to 1985 and 1987, when some of the properties were sold.4

The Bank's argument relied precedents commonly referred to as the "developer line of cases." The seminal case on this issue is Kentucky Land, Gas & Oil Co. v. Commissioner.5 The taxpayer in that case was a corporation engaged in the business of selling lots in a tract of land that contained oil deposits. Purchasers were entitled to a proportionate share of any income resulting from the extraction of oil from any portion of the tract. The taxpayer obligated itself to each purchaser to drill one well in the tract. The taxpayer took the position, and the Board of Tax Appeals agreed, that the taxpayer was entitled to include in the basis of lots sold during the tax year a proportionate share of the estimated cost of drilling the well, since the cost of drilling the well was in effect an additional cost of each lot sold.

Cambria Development Co. 6 was the first case to apply the holding of Kentucky Land to a developer of residential properties. In Cambria, the developer sold individual lots in a residential tract and agreed with each purchaser to construct streets and install water mains throughout the tract. The court allowed the developer to

add the estimated cost of those improvements, to be incurred after the sales, to its bases in the lots as computed at the time of each sale.

Cambria was followed by several cases, all of which involved costs of one kind or another incurred by residential developers. For example, in Laguna Land & Water Co.,7 the cost of streets to be built by a developer were permitted to be added to the basis of residential lots. In Country Club Estates, Inc.,8 a developer who donated land to a country club for use as a golf course was permitted to add the cost of the donated land to the basis of adjacent residential lots because "the basic purpose of (the taxpayer) in transferring the land was to bring about the construction of a country club so as to induce people to buy nearby lots."

Subsequent cases imposed some limits on the scope of this rule. In Colony Inc.,9 the court held that the cost of a water supply system could not be added to the cost of lots in the development for which the system was built because the developer retained full ownership and control of the water system.10 The court in Colony relied on an earlier case, Biscayne Bay Islands Co.,11 which held that the cost of land set aside by a developer as a playground in a residential subdivision could not be added to the basis of lots in the subdivision because the developer retained a reversionary right in the playground effective upon the expiration of a ten-year period.

The principles of the foregoing cases were distilled by the Tax Court in Estate of Collins.12 There, a developer constructed a sewage system and transferred title to a trustee while retaining a reversionary interest in the event the local municipality undertook to extend its sewage system to the development. The court concluded that under the developer line of cases, if a developer constructs a facility the "basic purpose" of which is to induce sales of the lots in the development, then the cost of the facility is added to the basis of the lots, even though the developer retains "tenuous rights without practical value" to the facility. However, if the developer retains full ownership and control of the facility, then the cost of the facility is not includible in the basis of the lots.

The tests set out in Collins were applied in two subsequent decisions. Willow Terrace 13 permitted a developer who constructed a water and sewage system to include the cost of those systems in the basis of subdivision lots. The court found that even though the water and sewage facilities were ultimately sold at a profit, the basic purpose of the developer in constructing the facilities was to induce sales of the lots. In Noell,14 a developer constructed an "air park" facility, in which homes abutted an airstrip, so that homeowners in the air park could keep private planes in their backyards directly off the airstrip. All of the homes in the development were constructed on one side of the airstrip. The other side of the airstrip was purposely left vacant so that it could be used in the future as a site for a commercial hangar. The court ruled that the basic purpose test was not met as a result of the planned future commercial use of the airstrip, and the developer was not allowed to allocate the cost of the airstrip to the cost of the adjacent homes.

The Tax Court's Analysis in Norwest

In Norwest, the IRS argued that the principle of the developer line of cases is limited to developers of residential real property. The court, however, agreed with the Bank that the principle of the developer line of cases is not to be construed so narrowly and could apply to any owner of property who builds a "common improvement" to benefit adjoining properties.

Thus, the court held that if the Bank could show both that it (1) had constructed the Atrium with the basic purpose of inducing sales of the Bank's adjoining properties and (2) had not retained full ownership and control of the Atrium, the cost of the Atrium should be added to the basis of the adjoining properties. The analysis of the court focused primarily on the first prong of this test.

The court found that the Bank did not meet the basic purpose test. The Bank was unable to show that at the time the Atrium concept was initially presented to the Bank's board of directors, in the late 1970s, the Bank had any plans to sell any of the adjoining properties. Therefore, the court concluded that the initial approval of the Atrium was clearly not for the purpose of inducing sales of the adjoining properties. Furthermore, reports

prepared for the Board before the ultimate approval of the budget for construction of the Atrium indicated that the Atrium should not be built if the Bank could escape from its obligations to build the Atrium, unless the Bank believed that the enhancement to the Bank's image made it worthwhile to proceed. Moreover, one of the reports concluded that the construction of the Atrium would impede further development of the block on which it would be situated and thereby probably reduce the maximum selling price of the adjoining properties.

Accordingly, the court concluded that the primary purpose of the Atrium was to "address certain design issues" (i.e., to counteract the off-Broadway location of 1UBC and to create a major center consisting of 1UBC and the existing Bank properties) and to enhance the Bank's image, rather than to enhance the value of the adjoining properties for the purpose of inducing sales of those properties.

Impact of the Decision

The Tax Court appears to have reached the correct conclusion in holding that the rule of the developer line of cases regarding the treatment of costs of common improvements is not limited to developers of residential real property. One aspect of the court's decision is very troubling, however.

The court appears to concede that the Bank intended to benefit the adjoining properties by solving design issues relating to the off-Broadway location of 1UBC and by enhancing the rental value of all of the adjoining properties. Nevertheless, according to the court, this motivation did not satisfy the basic purpose test. This result appears to flow from the court's framing the basic purpose test as requiring the taxpayer to have intended to induce sales of the adjoining properties. The court noted that "(the taxpayer) apparently acknowledges that a pivotal question is whether the basic purpose of the Bank in constructing the Atrium was to induce sales of the Bank's adjoining properties." The existence of this purpose was indeed a crucial fact in all of the developer cases upon which the court relied, where the adjoining lots were held by the taxpayer for sale. None of those cases, however, stated that the allocation of basis to adjoining properties could occur only if the benefited lots are intended by the taxpayer to be held for sale when the expenditures are incurred.

As a theoretical matter, it is hard to see why it should matter whether a taxpayer intends to sell improved lots in a development or instead to operate them in order to generate rental income.15 Concededly, this issue would ordinarily not arise if the taxpayer were not selling the lots, since the cost of the common improvement could presumably be depreciated by the developer regardless of whether its basic purpose was to benefit the lots in the development or to operate the common improvement at a profit (though there may be differences in the applicable recovery period and method of depreciation). As the facts in Norwest show, however, a taxpayer may construct a facility to benefit an adjoining property, initially planning to operate the adjoining property for rental income, but later decide to sell the property instead. The issue could also arise if the taxpayer claims a casualty loss as a result of the destruction of the property by fire. Arguably, a taxpayer in those situations should be treated no differently from the developer who initially planned to sell his properties. It would seem that a more correct statement of the basic purpose test should be whether the basic purpose of the taxpayer in constructing the common improvement was to benefit the adjoining property. Thus, the Tax Court's finding that the Bank constructed the Atrium for the purpose of solving the "design issues" that obviously affected the potential rental income from the adjoining properties should, at least arguably, have been helpful to the taxpayer's position.

It is not clear what the result in the case would have been in Norwest if the court had treated the Bank's desire to resolve the design issues and thereby enhance the rental income of the adjoining properties as being an acceptable purpose under the basic purpose test. It appears that the Bank probably would not have prevailed even if the court had concluded that enhancement of the Bank's image alone was the basic purpose of the Atrium. The opinion states, although the court's finding with respect to basic purpose made further analysis of the Bank's retained interest in the Atrium unnecessary, that the court believed an analysis of the Bank's retained interest would lead to the conclusion that the Bank had not given up sufficient control of the Atrium. In support

of that belief, the Court cited the Bank's sale of an undivided 48% interest in the Atrium for $17.1 million in 1988, which suggested that the Bank retained substantial ownership rights in the Atrium.

The taxpayer might have prevailed on the ownership and control issue if the court had accepted the view that the sale-leaseback transaction was really a disguised financing. As noted above it seems likely that the Atrium had no independent economic value to the Bank, once it sold the adjacent properties. But the Bank's shifting positions with respect to the tax treatment of seemingly uneconomic transactions did not help to persuade the court of the merits of the Bank's views.

The court's narrow view of the scope of the basic purpose test might have been justified if the court were viewing the costs incurred by a developer for the purpose of inducing sales of adjoining properties not as an expenditure increasing the basis of the adjoining lots, but rather as a cost of making the sale, which ordinarily would reduce the amount realized on the lots sold. For example, it is hornbook law that commissions paid on the purchase of property increase the taxpayer's basis in the property, and that commissions paid on the sale of property reduce the amount realized. (See, e.g., Treas. Reg. Para. 1.263(a)-2(e), with respect to the treatment of commissions paid in connection with the sale of securities. Such commissions are treated as an offset to the sales price of the securities rather than an adjustment to basis.) If this were the theory of the developer line of cases, it would make sense to limit the application of the rule to cases where the developer constructed the common improvement in an attempt to sell the adjoining properties. Only in such cases is it fair to describe the common improvement as a cost of the sale eligible to reduce the amount realized on the sale.

The developer cases, however, clearly state that the cost of a common improvement increases the basis of the adjoining property rather than decreasing the amount realized. Moreover, the court in Norwest specifically stated that "the developer line of cases addresses the basic problem of what constitutes a proper adjustment to the basis of property in the context of a common improvement that benefits lots in a subdivision."

There is a superficial resemblance between treating an item as an addition to basis and treating it as a reduction of the amount realized since, by definition, basis is the amount by which the amount realized by a seller must be reduced to arrive at the seller's gain. However, there are significant differences between treating an item as an addition to basis and treating it as an offset to the amount realized.16 The court's description of the cost of the Atrium as an addition to basis is clearly inconsistent with viewing the cost as merely a reduction in the sale proceeds. Furthermore, the treatment of the common improvement as an addition to basis is theoretically correct, since the common improvement enhances the value of the adjoining properties. Courts have applied a similar analysis to fix-up costs incurred by an owner of real estate in anticipation of a sale of the property, treating such costs as additions to basis and not merely as reductions in the amount realized.17

Other Theories

While the taxpayer failed to convince the court that it was entitled to allocate the cost of the Atrium to the bases of the adjoining properties, there might have been an opportunity for the taxpayer to achieve some recovery of the cost of the Atrium on a different theory. One avenue left largely unexplored by the parties in Norwest is the extent to which the Bank, the seller of the property benefited by the common improvement, might be viewed as having also sold an interest in the common improvement. Each of the purchasers who acquired property from the Bank was granted an easement over the Atrium (relating to pedestrian access) and received covenants from the Bank regarding the continued maintenance of the Atrium. Arguably, a substantial amount of value could have been allocated to those rights by the taxpayer. The Tax Court referred to this issue, stating:

Actually, in most of the cases, the asset involved is encumbered with rights running to the property owners which significantly diminish the value of an asset which nevertheless retains substantial value. This diminution, resulting from restrictions benefitting the adjacent lots, represents a pro tanto disposal with each lot. However,

there is no basis in the decided cases, and certainly none in the record before us, for making an allocation based on the rights disposed of and the property retained.

One method of making such a basis allocation might be to allocate a fraction of the cost of the common improvement to each property right sold, with the fraction determined by comparing the relative fair market value of the rights sold to the value of the rights retained. See Eileen Hunter v. Commissioner, 44 T.C. 109 (1965); Rev. Rul. 71-567, 1971-2 C.B. 309.

Another possibility would be to look to the cases that deal with sales of easements, where courts have allowed the seller to reduce its basis in the property by the entire amount of the proceeds realized from the sale of the easement, with only the excess being treated as gain.18 It would then be necessary for a determination to be made as to what portion of the consideration for the sale is allocable to the rights granted to the purchaser in the common improvement. Given the court's favorable nod to this argument, similarly situated taxpayers would be well advised to develop a factual record upon which such an allocation could be made.

A similar approach might be taken with respect to the Bank's affirmative covenants to maintain the Atrium and to operate it in an attractive and orderly manner. Assuming that the Bank anticipated that the operating income from the Atrium would not be sufficient to cover the Atrium's operating costs, the covenants represented a liability of the Bank to which a portion of the purchase price of the adjoining properties could have been allocated.19

Another interesting angle that was not explored by the court or the parties is suggested by the fact that a primary purpose of the Atrium was to improve the image of the Bank. It could be argued that the Atrium was in part an expenditure for the creation of goodwill. There appears to be no authority that would treat any portion of expenditures to erect improvements on real property, whether to serve as a company's headquarters or otherwise, as not being depreciable or as a separate "goodwill" asset for tax purposes. Consideration of these issues in depth is beyond the scope of this article, but a few points may be worth noting. Even if a portion of the cost of the Atrium could be characterized as an advertising expenditure, that amount would not be immediately deductible under the circumstances of Norwest. The Atrium is a tangible asset with a significant useful life, and should not be treated in the same manner as advertising designed to create institutional goodwill.20 As the tangible nature of the Atrium leads to the conclusion that the cost should be capitalized, the Atrium's basis should be depreciable in the same manner as any other tangible asset having a limited useful life held for use in a trade or business.

Conclusion

The effect of Norwest on similarly situated taxpayers in the future may be limited, since the issues considered by the court are now governed largely by the uniform capitalization rules of Code section 263A. Nevertheless, taxpayers who are unable to satisfy the regulatory requirements for adding the cost of a "common feature" to the bases of adjoining units may find themselves in a similar predicament to Norwest's, where an adjoining property is sold and the taxpayer is left with an asset of negligible (or even negative) value, but having a large basis that may be recoverable only by depreciation over an extended period.

A taxpayer in this position will in many cases be much better off selling the common improvement together with the adjoining property, securing an immediate recovery of the cost of the common improvement. Where this option is not available, the taxpayer should attempt to recover at least a portion of the cost of the common improvement by properly accounting for any easements or other rights in the common improvement transferred to the purchaser of the adjoining property. Taxpayers would be well advised to establish early in the planning stage of a development which improvements or empty spaces are intended to be common improvements, i.e., largely benefiting the adjoining properties. In the case of a sale of such an adjoining property, it might be helpful to spell out the values the parties are attributing to any rights in the common improvement that are transferred

together with the adjoining properties, so as to establish a strong factual foundation for allocating basis to those rights. Taxpayers also should consider whether any obligations involving maintenance of the common improvement have been undertaken in the transaction to which a portion of the consideration received may be allocated.

FOOTNOTES

1. 111 T.C. 105 (1998).

2. It is not entirely clear from the description of the facts contained in the court's opinion whether the 1700 Partnership was related to the Bank, though there is a hint that the Bank may have been an indirect partner. The court quotes the Eastdil report, one of the reports prepared for the Bank regarding the construction of the Atrium, as stating, "It is clear that the Bank has an obligation to its partners and to the tenants in (1UBC) to complete construction of the atrium facility . . ."

3. The Court's opinion is not entirely clear as to how long the obligation to maintain the Atrium was to run, but the language suggests that the obligation was to run for 35 years.

4. The Bank also argued before the Tax Court that the 1988 sale-leaseback transaction should be recharacterized as a loan. The facts suggest that the desired recharacterization had merit, at least as a matter of economic substance. There were substantial operating losses with respect to the Atrium for the years 1989 through 1995, and it seems unlikely that the Atrium could have been worth anything approaching the $35 million value for the property suggested by the purchase price paid for the 48% interest ($17,100,000/.48 = $35,625,000). The court addressed that argument at length and ultimately rejected it concluding that the Bank was bound to the form in which it had chosen to cast its transaction.

5. 2 B.T.A. 838 (1925).

6. 34 B.T.A. 1154 (1936).

7. 119 F.2d 112 (1941).

8. 22 T.C. 1283 (1954).

9. 26 T.C. 30 (1956).

10. The developer charged lot owners for the water provided to them.

11. 23 B.T.A. 731 (1931).

12. 31 T.C. 256 (1958).

13. 345 F.2d 933 (5th Cir. 1965).

14. 66 T.C. 718 (1976).

15. The developer line of cases has been "codified" and perhaps broadened by the regulations under section 263A, which specify when the cost of an improvement that qualifies as a "common feature" is allocated to benefited "units" of real property. Treas. Reg. Para. 1.263A-10(b). The Atrium appears to have been largely constructed prior to the effective date of section 263A and the regulations thereunder. A discussion of the regulations is beyond the scope of this article, other than to note their mandate that the cost of a "common feature" be allocated to units of property benefited by the improvement regardless of whether the taxpayer intends to sell the property. See Treas. Reg. Para. 1.263A-10(b)(6), Example 3.

16. For example, if property is sold in a transaction qualifying for the installment sale method of accounting, then the amount of the property's basis is relevant in determining the amount of debt that may be assumed by the purchaser without being deemed a cash payment in the year of sale. Treas. Reg. Para. 15A.453-1(b)(3). The installment sale regulations reverse the normal rule and specify that sales commissions paid in an installment sale are treated as additions to basis rather than reductions of amount realized. Treas. Reg. Para. 15A.453-1(b)(2)(v).

17. See e.g., Lapoint v. Comm'r, 94 T.C. 733, 735 (1990) (cost of drapes, erecting a fence, and other items incurred in anticipation of sale increase the basis of the property).
18. See e.g., Inaja Land Company v. Comm'r, 9 T.C. 727 (1947), acq., 1948-1 C.B. 2.
19. See Oxford Paper v. Comm'r, 194 F.2d 190 (2d Cir. 1952) (taxpayer's receipt of property in consideration of its assumption of an unfavorable lease does not result in income to the taxpayer).
20. Compare Rev. Rul. 92-80, 1992-2 C.B. 57 (allowing a current deduction for institutional goodwill advertising) with Rev. Rul. 68-360, 1968-2 C.B. 197 (cost of printing a trade catalogue for circulation among prospective customers must be capitalized where the useful life of the catalogue is more than one year). The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.
Roberts & Holland
Worldwide Plaza 37th Floor
825 Eighth Avenue
New York
NY 10019
UNITED STATES
Tel: 2129038700
Fax: +12129743059

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As San Francisco and the rest of the Bay area continue to lure dot.coms, the region's real estate market reaches new heights.

Ask for information about real estate markets in the San Francisco Bay Area today and you're very likely to get answers like "white hot," "red hot" or just plain "hot." It doesn't matter which category you're asking about - office, industrial, retail or multifamily - the answer almost always comes out as a variant of the above.

With good reason. As ground zero in the communications revolution, the Bay area is not just thriving but booming, and booming in a manner never quite seen before. Unlike the speculative boom of the 1980s, there is little overbuilding, high-risk lending or charging forward on a wing and a prayer.

In the words of Allen Palmer, senior vice president of marketing for San Mateo, Calif-based Legacy Partners, "It's a very balanced market." What's more, he adds, it looks as if it's going to stay that way for the foreseeable future. "I think we've still got legs in this economy," he says. "Our market cycle has a way to go."

But if it's balanced, it's balanced at a very great height. This teeter-totter is not 18 inches off the ground but 18 stories. The market has reached these giddy new heights, thanks largely to the visionaries who, 30 years ago, made the jump from typewriter to computer keyboard, and more recently recognized the leap from reality to virtual reality as the key to the future.

Nothing reflects the current boom more strikingly than the San Francisco office rental market. According to Bethesda, Md.-based CoStar Group International Inc., the City by the Bay has the highest average Class-A office rental rate in the nation at $78.29 per sq. ft. per year, topping second-place Manhattan's $67 per sq. ft. average by more than 15%. The rate continues to rise, with a growing number of leases coming in over $100 per sq. ft.

Even more remarkable is that at least one submarket tops San

Francisco. An invasion of venture capitalists has driven rents around Stanford Research Park in Palo Alto through the roof, with the average rent approaching the three-digit mark and rents topping out above $140 per sq. ft.

Record rents

Downtown San Francisco is not the only area experiencing record rents. Virtually every Bay Area submarket is doing likewise. For example, according to Los Angeles, Calif.-based CB Richard Ellis, rents on the San Francisco Peninsula have gone up for six straight quarters, with monthly Class-A rates at an astounding $8.50 per sq. ft. and Class-B at $7.36 per sq. ft. The brokerage reports a stratospheric $12 per sq. ft. for the Menlo Park/Palo Alto submarket.

Even downtown San Jose and downtown Oakland, both of which have struggled gamely for several decades to earn a little respect, are experiencing rapid turnarounds. According to Mark Ritchie, president of Ritchie Commercial Real Estate in San Jose, the downtown San Jose office market is setting "new high-water marks for Class-A space," with some monthly rates hitting $5.50 per sq. ft. to $6 per sq. ft.

Based on statistics from CB Richard Ellis, Class-A rates in downtown Oakland are approximately $4.50 per sq. ft. to $5 per sq. ft., up from approximately $3 per sq. ft. a year ago. Vacancies in both markets are under 2%.

The low vacancies and climbing rents also have sparked new development in those markets. San Francisco-based Shorenstein Co. L.P. recently broke ground on downtown Oakland's first private-market office building in a decade, the 472,000 sq. ft. 555 City Center, while no less than three new office towers are under construction or in the planning stages in downtown San Jose.

The reason for the turnaround, says Ritchie, is not simply a matter of low vacancies in surrounding markets forcing tenants to consider locations they previously would have rejected. It is also a matter of meeting the tastes of a new generation of employees.

"There is a compactness and synergy [downtown] that is attractive to technology companies," explains Steve Botto, a vice president at Ritchie. "What I'm hearing from a growing number of tenants is that they're not able to attract the people they need to build their business unless they're in the heart of things. Their employees don't want to be in East Hopscotch."

Brokers in "East Hopscotch" don't fully agree because a large number of Internet-related companies also have chosen to locate in more outlying areas. PeopleSoft Corp., Groundswell and Greenlight all are headquartered in the Tri-Valley area of southern Alameda County, and

Sybase Corp. just broke ground on a new headquarters campus there.

Sales prices, not surprisingly, are right up there with rents. Several recent San Francisco office sales came in over $400 per sq. ft., and 223 Fremont Street sold for a remarkable $470 per sq. ft. Virtually every other submarket also reported record deals. For example, San Mateo Plaza, an eight-story, 135,085 sq. ft. office building in San Mateo recently sold for $49 million, or $370 per sq. ft. That is the highest rate ever paid on the Peninsula, according to Gary Willard of CB Richard Ellis. However, he notes that there are at least two Peninsula properties for sale with asking prices of more than $425 per sq. ft.

Amazingly, prices seem not to have peaked. Willard says he expects prices to rise at least 10% throughout the Bay area by the end of this year. That estimate, he adds, is conservative. He and others anticipate prices soon reaching $500 per sq. ft. in San Francisco.

One of the big questions in the investment market concerns the value of dot.com tenancies. Internet-related businesses make up a significant portion of the tenant market today, but their lack of a track record makes some investors uneasy. Despite glorious beginnings, several prominent dot.coms already have gone under, so buyers can't help but wonder whether a 10-year lease with "whosit.com" means anything.

Legacy's Palmer says his company got one resounding answer in the affirmative, though not from the investment market as anticipated. Inktomi Corp., which last year signed a 10-year lease for 177,000 sq. ft. in Legacy's 262,000 sq. ft. Bayside Towers complex in Foster City, worked out an agreement to buy the property through a synthetic lease.

Although a fair number of tech companies have used this approach to develop corporate campuses, to Palmer's knowledge, this is the first time it has been used to buy an existing project originally built on spec. Furthermore, he reports Legacy has several other similar deals in progress.

Although this approach could provide a great exit strategy for some landlords with large, successful dot.com tenants, it doesn't indicate how investors view the situation. This year's only office building sales in San Francisco's South-of-Market district, the very heart of the multimedia and Internet revolution, suggest buyers are very cautious.

Where Class-A buildings in the city's traditional Financial District now routinely sell at prices in the $400 per sq. ft. range, two Class-A buildings south of Market Street leased almost entirely to

dot.com tenants sold for an estimated $300 per sq. ft. each. This is despite the fact that rents in both areas are equal.

Not all submarkets are equally expensive. 1333 Broadway, a 10-story, 238,000 sq. ft. office building in downtown Oakland, recently sold for $31.75 million, or $133 per sq. ft. According to Mark Krol, a broker with CB Richard Ellis, the buyers got an exceptionally good deal.

Sizzlin' Sacramento

San Francisco's neighbor to the east, Sacramento, also boasts a sunny real estate climate. According to Los Angeles-based CB Richard Ellis, economic conditions in the Sacramento area remained strong during the second quarter, with unemployment dropping to 3.7%, the lowest level in 50 years.

The office market remained healthy in the first half of the year, with construction activity increasing. CB Richard Ellis reports that the overall vacancy rate was 7.13% in the second quarter, a slight decrease from the previous quarter, and eight buildings totaling 525,000 sq. ft. were introduced into the market. Another 1.4 million sq. ft. of office space was under construction at the end of the second quarter. One of the city's biggest office projects in recent years was the $65 million Esquire Plaza, which also includes a restaurant and IMAX theater. Completed in 1999, the building was developed by San Diego-based Lankford & Associates.

According to CB Richard Ellis, the Sacramento retail market sizzled in the second quarter. More than 2.4 million sq. ft. of space was under construction, and at least 31 major retail projects totaling 4.7 million sq. ft. were in the planning stages or under construction.

The industrial market also remained strong during the first half of 2000, especially along the Interstate-80 and Interstate-5 corridors. More than 800,000 sq. ft. of new construction was completed in the entire region during the second quarter, and 45 industrial buildings were under construction. These buildings will bring more than 4.6 million sq. ft. into the market in the next six to 12 months, and vacancy rates are expected to remain healthy, in the 5% to 7% range.

Evolving industrial market

In terms of conventional industrial uses, the majority of new manufacturing and distribution development has been shunted to a few submarkets: Hayward-Union City, Richmond, Livermore, Concord and Sonoma County. But that hardly means the existing markets have disappeared. Oakland still has about 33 million sq. ft. of industrial product, while San Jose, the heart of Silicon Valley, has even more.

But as with offices, vacancies are very low. Even in Hayward-Union

City, the largest industrial submarket on the east side of San Francisco Bay with some 57 million sq. ft. of product, the vacancy rate was 3.3% in June, down more than two points since January.

"The market's much more competitive than in the past," asserts Greig Lagomarsino, a senior vice president in the Oakland office of New York-based Colliers International. He mentions a typical scenario of three and four tenants bidding on any space that becomes available in the submarket, explaining the competition is being driven by companies seeking to escape the high rents of the Peninsula and Silicon Valley. Where Hayward and Union City start at about 45 cents per sq. ft., markets on the west side of the bay start at $1 per sq. ft.

In many submarkets, industrial product is being converted to high-tech uses. Fremont, once a hub of manufacturing, has become an extension of Silicon Valley, with existing projects rapidly converting to research-and-development use due to starting rents of 80 cents per sq. ft., according to Lagomarsino. In San Francisco, approximately half the industrial and service space left in the city in 1990 has been converted to multimedia and Internet use or loft-style residences, and the conversions have not stopped.

The conversion phenomenon is spurred not only by a shortage of office space but also by a desire from today's technology and Internet firms for "funky" space that goes against the button-down ideals of traditional business. This summer, the San Francisco-based Martin Group acquired a Nabisco Inc. distribution center in Brisbane for conversion to office space for dot.com and related companies. According to Michael Prudhomme, a vice president in the San Francisco office of Colliers, the redesign will retain as much of the building's industrial character as possible.

A good indicator of the west sub-market's push to high-tech use is the estimated $140 per sq. ft. Martin paid for the Nabisco property. An even better indicator is Xilinx Inc.'s purchase of 200,000 sq. ft. of flex space in San Jose for $340 per sq. ft.

Retail redevelopment

Although the Bay area's wealth makes it a prime target for retailers, the region has been characterized by an imbalance between demand and development for at least a decade. As a result, the area is dramatically "understored," at least in the opinion of most retail analysts.

There are very few new sites available for development, and most of those are at the outermost edges of the region. And even some of these are available more in theory than fact due to continuing

conflicts over preservation of open space and agricultural land. In August, for example, the Contra Costa Board of Supervisors modified urban limit lines to exclude 14,000 acres that had previously been earmarked for development.

Consequently, developers have little choice but to redevelop or convert existing sites. The three largest retail projects currently under development all entail reuse of existing sites. Furthest along is Santana Row, a project by Rockville, Md.-based Federal Realty Investment Trust, at the site of a former San Jose strip shopping center. Currently under construction, the project will mix 680,000 sq. ft. of retail with 1,200 residential units.

Madison-Marquette, Cincinnati, is preparing to begin construction on a large mixed-use project with 400,000 sq. ft. of retail on a rezoned industrial site in Emeryville. Cleveland-based Forest City Development is seeking approvals for a 1.4 million sq. ft. mixed-use project in San Francisco built in the shell of the shuttered Emporium department store. All three projects also include hotels.

Fortunately, the area's high rents make the costly and time-consuming redevelopment process worthwhile for owners and developers. On San Francisco's Union Square, annual rents above $300 per sq. ft. have been standard for several years, but now local brokers report landlords have been asking $150 per sq. ft. for spaces off the square that rented for $50 per sq. ft. as recently as 1998.

Rents are rising dramatically outside the city as well. According to Craig Semmelmeyer, a principal of Main Street Retail Advisors in Lafayette, Calif., Tiffany & Co. signed a lease for 9,000 sq. ft. in downtown Walnut Creek at $5.40 per sq. ft. per month, the highest retail rent ever recorded in Northern California outside San Francisco. Vacancy rates under 5% in almost all major submarkets and as low as 2% in some markets account for the steep rents, according to reports from CB Richard Ellis.

Of course, steep prices also are the norm. As in other categories, retail properties are selling for record rates. According to Timothy Rosten, a former vice president in the Oakland office of CB Richard Ellis, the owner of a fully leased, 15-year-old center anchored by a supermarket in San Leandro is asking $172 per sq. ft. for the property on a cap rate of 8.9%.

The living isn't cheap

According to the California Association of Realtors (CAR), Bay area home prices rose 8% to 29% in the last year, depending on the submarket. A recent report to the San Francisco Board of Supervisors indicated only 18% of local households can afford a median-priced

home, which now exceeds $500,000, including both single-family homes and condominiums, according to CAR.

The same competition for space that has driven home prices to record levels has driven up apartment rents as well. Palo Alto, Calif.-based Marcus & Millichap Commercial Real Estate Investment Brokerage Co. ranks San Francisco, San Jose and Oakland the second, third and sixth most expensive apartment markets in the nation, respectively.

A recent report from the San Francisco Association of Realtors reveals the average rent for a two-bedroom apartment in San Francisco is $1,900 a month, and rising. Rents in Marin, San Mateo and Santa Clara counties are at equivalent levels. Other markets are less expensive, but finding a two-bedroom apartment under $1,000 per month is nearly impossible throughout the Bay Area.

Research from the Association of Bay Area Governments (ABAG) indicates need far outstrips production of both for-sale and rental units. The U.S. Bureau of the Census reports Bay Area developers pulled permits for 302 multifamily projects with a total of 5,349 units in the first seven months of 2000. ABAG estimates a need for at least twice that number of units.

Statistics such as these obviously lay the groundwork for a strong investment market. Since the nine-county Bay area population is projected to grow from 6.9 million in 2000 to 8 million in 2020, the market will only get stronger. According to Larrie Furst, director of investment sales at TRI Cold-well Banker in San Francisco, owners are holding on to their properties because they are enjoying good returns. Legacy's Palmer notes local jurisdictions are aggressively promoting high-density, mixed-use projects that combine multifamily residential with office or retail uses.

Hotels in demand

L.R. Waterman, associate vice president of Colliers International Hotel Realty in San Francisco, uses the ubiquitous term "white hot" to describe the region's hotel market. "The demand for hotels is tremendous," he says.

According to Anwar Elgonemy, an associate with San Francisco-based PKF Consulting, the region's occupancy levels rose 7% from January through June. He says the average daily room rate (ADR) went up 8.5 % in the same period.

San Francisco proper has posted even more dramatic results, making it one of the strongest hotel markets in the United States right now, he adds.

By PKF's calculations, the city's ADR has risen 10.3% to a current

level of $161 per night, putting it second only to Manhattan. Meanwhile, occupancy has increased from 78% for in 1999 to 84% for the first eight months of 2000.

A confluence of factors has produced the happy results, the two analysts point out. To begin with, the strong U.S. economy has given people the opportunity to travel more often and for longer periods.

As one of the most popular tourist destinations in the world, the San Francisco area benefits greatly from this trend. In addition, notes Elgonemy, both San Francisco and San Jose are enjoying banner convention years. Convention business has been so strong, in fact, that San Francisco has a half-block underground extension of Moscone Convention Center under construction, while San Jose will decide shortly whether to move ahead with an expansion that would nearly double the size of the McEnery Convention Center.

According to PKF, despite nine straight years of increasing occupancy levels, San Francisco's inventory of rooms increased only 6.5% between 1991 and 1999, an addition of 1,900 rooms.

However, more than 1,000 rooms are under construction and slated to open between now and 2002. That includes the 108-room Orchard Hotel and 253-room Holiday Inn Express slated to open later this year, the 400-room Four Seasons and 414-room Courtyard by Marriott scheduled to open next year, and the 360-room Omni slated for a 2002 opening.

Other projects are in the pipeline. Two large convention hotels are under development in San Jose, and several smaller full-service hotels are planned at various commercial hubs throughout the region. For example, San Francisco's Kimptom Hotel Group plans a 224-room facility as part of Cupertino City Center.

Despite the new projects, Waterman and Elgonemy say there is room for more. Neither analyst believes overdevelopment will occur due to the high barriers to entry, particularly in San Francisco and on the Peninsula. Barriers include competition for capital and space, a demanding regulatory environment and extremely high construction costs.

Elgonemy gives the region very high ratings in terms of potential returns, but adds that few properties are on the market because owners are enjoying their profits rather than selling. However, Waterman reports Colliers is marketing several hotels near San Francisco International Airport, all of which are for sale because their owners are looking to concentrate on the luxury market.

According to Elgonemy, when sellers do decide to sell, they expect a top price. He reports San Francisco's Westin St. Francis sold in

April for $243 million, or $204,000 a key, while the Westin Santa Clara sold in December for $110 million, or $218,000 a key. Buyers are reluctant to pay these rates, he adds, because the combination of high price and today's higher interest rates makes it difficult to clear a profit.

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Evidentiary Exhibit Number 86

The Washington Times
October 20, 2000, Friday, Final Edition
SECTION: PART F; FRIDAY HOME GUIDE; Pg. F1
LENGTH: 1411 words

HEADLINE: What to do with home you just inherited

BYLINE: Chris Sicks; SPECIAL TO THE WASHINGTON TIMES

BODY:

Inheriting a house can be an emotionally confusing experience. You just lost a parent, grandparent or favorite aunt and feel emotionally drained by your loss, yet you suddenly own a house, and you have to deal with that.

How do you proceed in a way that honors your loved one while protecting what they have given you? No one wants to feel greedy at a time like this, but it's reasonable to want to minimize your taxes and maximize your gain. Simply put, you'll need some help on this one.

An accountant - get one if you don't have one - will be an essential part of your team. Estate taxes tend to be confusing and complicated, which is why there is such broad support for a repeal of the "death tax." For now, however, you'll need to do some math.

"The number that matters most is $675,000," according to Rob Huey, president of the accounting firm Huey & Associates in Bethesda. "Whenever a person dies, an estate is created. If the value of all the assets in that estate is $650,000, you don't need to worry about the estate being taxed. But every dollar over $675,000 is taxable."

If the home you inherit was owned outright by your deceased relative, the current value of the home is added to the estate's total value. If however, a mortgage or equity loan remains to be paid, the balance on the loan is subtracted from the home's value.

For instance, if you inherit a home worth $800,000 but there is an unpaid balance of $300,000 on the mortgage, you really are inheriting only $500,000. Should you decide to sell the property, you'll need to pay the mortgage company $300,000 out of the proceeds. If you keep the home, you'll need to start making mortgage payments.

Obviously, determining the true value of all property in an estate is very important. That's why hiring an appraiser is another of the first steps you should take. Once you know just how much the estate is worth, you will be able to enlist the help of a Realtor and accountant to help you with the decisions you'll need to make.

Should you live in the home, sell it, rent it or just keep it? Each of these options has tax-related, legal, strategic and emotional implications. Because each situation is so personal, it's hard to find general advice that applies to each one.

"You know, in a very real sense, we are highly paid, professional counselors," says Mark McFadden, an agent with Pardoe Real Estate. "Buying and selling homes are some of the most stressful things anyone ever goes through. Add in the death of a loved one, and you can have a huge struggle ahead of you. That's why you'll need a tremendous amount of help."

Even if the house is next door, there's a lot to handle. But what if it is in Des Moines? What if it's in poor condition? Or suppose Uncle Mike wants to buy it from you. Maybe you should move into the property yourself and avoid all of this. Often, though, that's not an option, so many folks find they need to sell the home or rent it out.

The Washington market is very hot, so selling is a viable option, but Des Moines might be going through a slow period, making it unwise to sell a property there.

"You can't just go to another state and wing it," Mr. McFadden says. "It is hard enough to determine the value of your own home, so don't expect that you can evaluate the value of a property in a completely different market. You will need a pro from that neighborhood."

If you can't make a profitable sale at the moment, you may want to rent the home until the market improves.

"Some clients of mine inherited a property in the mid-1990s and felt the condition was very substandard," says Jean Andrews, president of the Anne Arundel County Association of Realtors. "They couldn't really afford to fix it up, so they rented it out and used the rental income to pay for renovations. When the market heated up recently, they were able to sell it at a very good price."

In the Washington area, renting also is a viable option now because the rental market is hot.

"But who will manage it?" Mrs. Andrews asks. "Unless you live nearby, are handy and have free time, you will probably want some help with finding tenants, collecting rent and arranging for repairs."

Fortunately, there's a whole fleet of Realtors who specialize in property management. Their fees might seem large at first - often 20 percent of the rent - but the assistance they render could be worth it. Consider this: If the property sits vacant for even two months while you try to find renters by word of mouth, your losses approach 20 percent of a year's rent.

If you don't want to rent the property but are attracted to the idea of renting as an investment opportunity, you might want to play banker. "Holding a mortgage yourself when you sell is something most people can't do, because they need the proceeds from the sale to buy their next home or to pay off the bank," Mrs. Andrews says. "But now you own this inherited house outright. You can sell it to someone yourself and receive their monthly mortgage payments for the next 30 years."

There certainly are some risks in becoming a mortgage holder, but your accountant can help you sort things out.

Whatever you decide, you might have to share your plans with others. "If the home has been handed down to other beneficiaries besides yourself, but you are handling things, you are obligated to inform them of everything that's going on," Mr. Huey says.

If renting or playing banker seems like too much of a hassle, selling the house could be the simplest option. If you choose to sell, you'll have to learn some things about the property first. If you haven't been there much in recent years, you won't be familiar with any structural flaws that could impede the sale.

"When my client doesn't know the home very well, I always recommend a home inspection before we put it on the market," Mr. McFadden says. "If you find significant problems, you'll want to price it accordingly. There may be $30,000 of repairs needed to really get the home in top condition, but I'd advise you to lower the price rather than fix it up. It's going to be much easier on your family if you sell it as is, rather than trying to scrape up enough money from everyone to do work that may or may not improve the value of the home."

Determining the true value of a home can be tough. Home prices have shot up in some neighborhoods by 10 percent this year. Don't rely on the appraisal of the estate you have done for tax purposes as a guide to pricing the home for sale.

"In this market, a home may appraise for $450,000, but sell for $500,000," Mr. McFadden says. "That's where having a good agent comes in. Appraisers are very good at what they do, but they can't know the neighborhoods and current inventory as intimately as we do."

The true value of property is whatever it will sell for on the open market, no matter what the official-looking appraisal documents say. That's why you also should be careful if a friend or neighbor of your deceased relative offers to buy the property.

"It may seem easier just to sell it to Mr. Clark next door or to your cousin Sue," Mr. McFadden says, "but you should still use an agent and put it on the open market. That's the only way to see what market value for the home truly is and to keep everything professional and above board."

By the way, if you happen to be getting on in years yourself, you may want to take this opportunity to do some estate planning of your own. There are ways to help your inheritors avoid the death tax if your estate is going to be worth more than $675,000.

"A pretty standard tool we use is the Qualified Personal Residence Trust," Mr. Huey says. "This is a way for you to give your house to your children incrementally while you are still around."

Under federal tax rules, anyone can give anyone else a gift of $10,000 or less each year without its being taxed.

Using this established accounting procedure, you can transfer ownership of your home to your heirs in $10,000 increments each year. Over time, this can bring the value of your estate under the current "death tax" benchmark of $675,000. The estate exclusion amount is scheduled to increase to $1 million by 2006, but federal lawmakers also are considering repealing the tax altogether.

Your accountant can give you the details on establishing a Qualified Personal Residence Trust.
LOAD-DATE: October 20, 2000

Evidentiary Exhibit Number 87

The Oregonian

October 9, 2000 Monday SUNRISE EDITION

SECTION: LOCAL STORIES; Pg. A01

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HEADLINE: TROUBLED HOMES AMID PROSPERITY

SOURCE: GORDON OLIVER of the Oregonian Staff

DATELINE: HILLSBORO

BODY:

Summary: Two manufactured-housing parks in Washington County illustrate the crisis confronting the industry

Sandy and Al Mann watched their neighborhood come alive, filling up with new homes and families that had achieved their dreams of owning a home. The couple loved being around "real people" who lived ordinary lives, preferring their neighborhood of manufactured homes to a pretentious "Yuppie" community.

But just five years after they moved into the Baseline West manufactured-home park, their neighborhood is dying. Dozens of once-happy homeowners have abandoned their homes in the face of personal financial troubles, rising costs and fear that their homes are losing much of their value.

Now the homes are going out, too, cut in half and towed away, as new buyers pull out homes and lenders look elsewhere for buyers. About 40 homes in the 177-space park have been repossessed by lenders, and about a dozen homes have been moved out of the park, some by lenders weary of paying park rent. Another two dozen are for sale by their owners.

"It's so sad," said Al Mann, sitting in the living room of what was to be his retirement home. "There were a lot of real nice people here -- people you'd like to see as your neighbors."

Manufactured-housing industry leaders say they are looking for ways to recover from the industry's worst downturn in decades, which has reduced sales of new homes in Oregon by 40 percent from last year. The market is glutted with repossessed homes, sales in many manufactured-housing parks are stagnant, and prices are so low that many owners cannot sell their homes for what they owe on their loans.

The Oregon attorney general's office is preparing to examine the state's laws affecting manufactured-home sales and lending practices. Both industry and homeowner advocates are bracing for fights in the Legislature next year about rents and the sometimes conflicting rights of landowners and homeowners in manufactured-housing parks.

At the nearby 249-space Baseline Woods manufactured-home park in Aloha, residents are working with property managers and owners to stem a flow of people and homes out of the park. There are 12 vacant lots in Baseline Woods, the older of the two parks, and about 24 homes for sale by owners or lenders. So far it is homeowners, rather than lenders, who have pulled most homes out of Baseline Woods.

The two Washington County parks are among the most troubled in the state, reflecting the manufactured-housing industry's deep problems. Owned by the same local investment group, Cooper's Chase, they are trapped in squalls in Washington County's sea of economic prosperity, a contrast to the dazzle of the

nearby Orenco Station community and the jobs boom created by Intel, Sandy Mann's employer, and other technology firms.

The victims are people such as Sharon and Michael Henry, who had lived with their three teen-aged children in a house with a driveway flanked by two concrete lions made by Sharon Henry's father. The Henrys declared bankruptcy and moved in February, leaving the 150-pound lions for the next buyers. Sharon Henry, whose father died last year, cried when she visited a friend recently and saw workers digging away at the pedestals so they could move her former home.

Lost more than $30,000

They are people such as Laura and Jeff Potter, who lost more than $30,000 when they sold their home to avoid bankruptcy, or such as Chris and Nicole Duff, who left their unsold home in Baseline West in April and are awaiting a bill for remaining costs after their lender sells the home at a bargain-basement price.

"This is criminal. It's a racket," said Chris Duff, who has moved with his family to Vancouver, Wash. "I don't care if they are protected by the law. It's a criminal act, and shame on all of them."

Charles W. Merrill, a Washington County land developer who is managing partner for the park's investor owners, says he is unhappy with problems in the parks but blames lenders, dealers and the residents themselves.

"We're very discouraged with the fact that people are losing their homes, and we are very discouraged with the industry for conspiring with them," said Merrill, also a partner in the inactive Aloha Land and Cattle Co. that produced two Street of Dreams developments a decade ago. "I don't think too many [home buyers] went into it blindly. They might tell you they did, but I think there was collusion on all sides to get something for nothing."

Finger-pointing battles

Industry leaders and home buyers wage bitter finger-pointing battles about who is to blame for the meltdown among dealers, lenders, home buyers, park owners and government. Some think that all parties have contributed to damaging the industry's most valuable asset: its traditional ability to provide a decent home at an affordable price.

"The only reason a manufactured-home rental community exists is to provide an affordable housing option for a certain group of people," said Gub Mix, a national industry leader in Sun Valley, Idaho. "As long as the product and the space rent is affordable, then it is very successful. Once it stops being affordable, then it becomes a disaster."

The two parks on Baseline Road have different histories and different problems. But rents have risen dramatically in both parks, and residents fear that rents will reach levels they cannot afford.

The Manns paid a combined $435 for rent and water, sewer, garbage and cable when they arrived in 1995. Now they pay $550 for the same services, a 26 percent increase in five years. One increase was $50 in a single year. "I didn't expect it to rise that fast," said Sandy Mann.

Those rents, combined with payments on home loans, push monthly housing costs to more than $1,000 a month for most residents. Many, especially in Baseline West, have loans payments that increased after one year and buried the first-year's rent into the home loan. Their troubles began when costs went up after one or two years, combined with park rent increases.

At Baseline Woods, park owners pushed up rents in older parts of the park to match higher rents in newer phases as they opened. That created drastic single-year increases for some residents.

"I think there should be reasonable rent increases," said Judi Christensen, who works at Tektronix and has lived at Baseline Woods for six years. Christensen saw her payment for rent, water, sewer, garbage and cable go up $50 one year and $102 the next, to $559 now. "People need affordable places to live," she said. "I'm not a low-income person, and I'm hurting."

Surge of apartment building

By contrast, average rents on a two-bedroom apartment in the Portland area increased from $561 in 1995 to $645 last year, a 15 percent rise, said commercial broker Dean McGregor of Portland. A surge of building apartments in Washington County has dampened rents in recent years.

Merrill says he expects lenders to pull dozens of repossessed homes from his parks. He has refused to lower space rent for lenders, even though a break might keep some from moving homes out of the parks. Likewise, Merrill said he won't follow other park owners who have bought homes from lenders at discounted prices and sold them within the park.

"If [lenders] want to take them out, they can take them out," he said. "We will leave them empty until there are bona fide, qualified buyers who can buy homes and move them in."

Still, he says he can't blame the more financially healthy homeowners from moving homes out of the parks. "I never, ever wanted to see someone move a house out of the communities I was involved with," Merrill said. "But I could not argue with the folks who were giving their notice to move their homes out of Baseline Woods, because they were looking into the future and they were trapped. They could not sell their homes if they wanted to."

Merrill, who says he would rather build low-cost than luxury housing, said he tried to do things right. He did not impose costly "park packages" on new residents, instead absorbing development fees and other costs that some developers pass on to residents. And he developed a formula in his contract with residents to justify rent increases, based on a rise in the consumer price index and increases in park costs.

Dual obligations

But Merrill said the formula became a trap, forcing him to raise rents even after problems became apparent. His obligation, he said, is both to park residents and to investors in Cooper's Chase, and following the formula pushed rents to uncomfortably high levels.

"I don't care to be at the cutting edge," he said of his rents. "I was there and I know I was, but there wasn't a thing I could do about it. I was locked into that lease."

Merrill also said he felt he had to raise lower rents in Baseline Woods to make rents the same throughout the park. "You and I both know that if we're going to keep harmony in the community, we can't have a $75 difference between the first guy and the last guy to move in."

Most of the old leases have expired, and Merrill says he now has more freedom under a new formula to hold rents down. Residents still worry that investors may decide to raise their rents to compensate for lost income as homes are moved out of the park.

But Merrill's management company produced a letter last week promising no rent hikes in the next year and assuring homeowners that they don't intend to sell or vacate the park.

Some industry leaders say they disagree with Merrill's approach to problems in the parks.

Emily Cedarleaf, executive director of the Multifamily Housing Council, said she is not convinced that Merrill's investment firm was trapped into the rent increases by its contract formula.

"What tenant is going to take you to court because you didn't raise the rent?" she asked.

Don Kilpatrick, president of Commonwealth Brokerage and an investor in manufactured-home parks, said his company is taking a different approach. The firm purchased homes from lenders in one park, fixed them up and sold them on the open market. They say the market is less than $40,000 in a mid-Willamette Valley park with monthly rent of about $275. "Our mission is to make such an incredible deal that nobody will pass it up," he said.

At Baseline West, resident Fran Johnston, 56, feels that she and her family are among the losers. Johnston moved into the park five years ago and then urged her mother to join her when she moved from Pennsylvania. Johnston lives with her daughter and granddaughter, and her mother has her own home. She owes $67,000 on her home and says she can find no land in Washington County where she could move both her home and her mother's.

"There's nothing we can do," she said. "We're absolutely stuck."

Merrill says he treats residents more equitably than other owners would if he sold the park. He thinks the parks will be on stable footing within three years.

He said he regularly receives offers from investors willing to pay $40,000 to $50,000 per space or more to buy the parks. "I've got one sitting right here, in fact, with a picnic basket and two bottles of wine," he said. "I know I can get out from under this any time and make a lot of money." You can reach Gordon Oliver at 503-221-8171 or by e-mail at gordonoliver@news. oregonian.com.
GRAPHIC: Color Photo by DOUG BEGHTEL of The Oregonian staff
LOAD-DATE: October 11, 2000

Evidentiary Exhibit Number 88

The Washington Post
washingtonpost.com

The Washington Post

October 7, 2000, Saturday, Final Edition

SECTION: REAL ESTATE; Pg. G01

LENGTH: 2611 words

HEADLINE: Condos Reach New Heights; Development, Demand May Be Hottest Ever For D.C. and Suburbs

BYLINE: Sandra Fleishman , Washington Post Staff Writer

BODY:

The condo market in the District and close-in suburbs is at a fever pitch for resales, new construction and conversions of rental properties--and Tray Mitchell Jr. is one of the hundreds of reasons why.

The senior counsel at the Nasdaq-Amex Market Group had been renting for nine years at 16th and R streets NW when the building's owners decided last August that demand had risen sufficiently to convert some units to condominiums. The owners had filed the paperwork required by the District to convert 15 years ago, Mitchell said, but they held off as the condo market faltered and then went into a nose dive that was to last about a dozen years.

Though the soft-spoken North Carolina native had the first shot at buying his 700-square-foot rental, he chose to venture out into the market in search of a bigger property.

But he hit the same demand "frenzy," as real estate agents refer to it, that drove his former building owners to cash in.

"The market was so tight," said Mitchell, 36, that he found slim pickings around Dupont Circle or farther east and north. "There was no inventory. If anything stayed on the market for more than two weeks, it was overpriced. Most of them went in a day."

That near-instant turnover--for luxury units and for units of any kind in certain neighborhoods in the District, Northern Virginia and Montgomery County--contrasts with the market just a few years back, when real estate agents and owners would say you couldn't give most condos away. Though condos and co-ops have taken off before--in the 1970s, as developers looked for a way around rent control, and then briefly in the 1980s--this surge seems to be reaching new heights in price and demand. The District is the most sought-after location, according to agents, but the suburbs also are seeing faster resales and lower inventories in condos at all prices, as well as a steady pace of luxury condo construction.

Mitchell ended up buying a top-floor, two-bedroom condo at the Hampshire House just off Dupont Circle, but he had to pay a record price--$ 275,000. And he's spending another six figures to gut it and build the condo of his dreams.

Meanwhile, he has been sleeping on a friend's couch.

But, he added, it's worth the wait: Rather than trying to find a property that fit his ultimate shopping list and facing mountains of competing bidders, he's building his own luxury space. And he believes the building is ripe

for high-end redevelopment. Before it was converted, at the height of the last condo wave, it was a grand apartment building with a spacious lobby, high ceilings and bigger units.

Transforming what was available into what he really wanted was one way to overcome the District's tight inventory, which fell to an 11-year low in August, according to Pardoe Real Estate ERA's Fred Kendrick and Peter Clute.

Other would-be buyers are putting their names on waiting lists with developers who have projects in the works. Some are buying units being converted from town houses and single-family dwellings--often just outside the choicest markets, where land prices haven't yet gone through the roof.

Another source of supply is conversions of apartment buildings by developers working with tenants. Because insiders usually get hearty discounts on these units, those who can afford to buy are seriously considering that option when longtime landlords decide to sell in this brisk market. Half of the tenants must vote to convert before the process can go forward, under the District's complicated laws. At least two sizable apartment buildings in Northwest recently have been converted, and tenants in a 68-unit building on Connecticut Avenue are deciding whether to go that route.

What's driving the demand and building activity in the District and its most city-like suburbs? The same combination of factors pumping up other urban areas, say the experts: a strong economy, high job growth, subsequently wealthier potential buyers, and renewed interest from both empty-nesters sick of commutes and homeowner chores and from young professionals wooed by city lights and declining crime rates.

Washington has gotten a big leg up as well from the $ 5,000 federal tax credit for first-time home buyers and from continuing enthusiasm for Mayor Anthony A. Williams (D).

Combine that with the area's low rental vacancy rates, record-high rents and record prices for single-family houses in some neighborhoods, and the condo--and in particular, the luxury condo--sounds like an idea whose time has more than come.

This comes as no surprise to those at Northwest's luxury condo leader, PN Hoffman Inc.

When Lamont "Monty" Hoffman and Pete Nazelrod undertook their first luxury conversion of a row house on the fringes of Dupont Circle in 1993, they knew they were taking a big gamble. But it paid off. "We had 150 people waiting in line" at the first opening, Hoffman said.

"There were so many negative things happening" in the national housing market and "in the press about the city then," said Hoffman, "that we looked at it as a stock hitting bottom." What could make more sense than to jump in and pick up properties cheap?

"We're seeing the effects of a national trend," said Hoffman. "It used to be the condo was more of a utilitarian investment, something convenient, close to work. Now it's clearly a lifestyle choice."

The company's success proves his point.

From 1993 until late last year, the company had built 111 units. Since then, the firm--either solely or in joint ventures--has finished 44 units, is building 306 more and has another 220 in development in Northwest.

And the units are selling out months ahead of schedule, at prices that range from $ 239,000 to $ 1.5 million--about 5 percent more than just six months ago. (And, yes, that's $ 1.5 million for a condo--albeit a penthouse.) Because of advance sales, the company has a $ 125 million backlog, Hoffman said.

To accommodate the crush of would-be buyers, the firm in January set up a model showroom at 4700 Wisconsin Ave. NW, just down the street from a 41-unit condo project that recently sold out four months early. Since the company offers high-end kitchens, bathrooms, cabinets and other options in all its properties, it made sense to have a centralized design center such as major house builders have, Hoffman said.

Of course, you can spend a lot more than $ 1.5 million on a condo if you try. At the Residences at the Ritz-Carlton, at 22nd and M streets NW, prices run from $ 500,000 for a one-bedroom unit to $ 5 million for a three-level, five-bedroom penthouse with roof garden.

More than half of the 162 units have been sold, with the first owners expected to move in around November. (Of the 25 penthouses, 10 have been sold.)

But the Ritz is still considered an aberration locally because of its extraordinary prices and hotel-like facilities, such as maid service, a health club and catering.

It's not just the luxury market that's booming: Demand is strong in all price ranges. But high land prices make new development tough for all but the most clever developers. Those include Manna Inc., the District's leading nonprofit builder, and other cooperative ventures financed with the help of foundations and the D.C. Department of Housing and Community Development.

The DHCD, for example, provided $ 350,000 to the East of the River Community Development Corp. to help turn the Washington View Apartments into the Washington View Condominiums, a 70-unit project on Douglas Road SE.

Manna is building condos all around the District, including the Parkmont Condominiums, which recently opened at 529 Lamont St. NW. The well-restored, sunny building stretches down a long corner in Petworth and was created from a worn, 21-unit apartment property. It now features 14 two- and three-bedroom units costing from $ 55,000 to $ 73,000. Buyers at projects from Manna and other community housing groups must have incomes below certain ceilings.

Robert Pohlman, who tracks nonprofit building in the District, predicts that "if the housing market continues to be tight and prices remain high or even increase . . . more nonprofits will take the risk of producing more condo units."

But the biggest supply problem may be units in the price range just above the nonprofits' target.

"I don't know anyone going after the $ 100,000 to $ 200,000 market" because of the high land costs in the District, said Logan Circle luxury condo developer Jim Abdo. "You'd be losing money."

Instead, the for-profit players are either building ever-more-expensive units in lot in prime neighborhoods that have been skipped over, or are building luxury units in fringe areas around pricey Dupont Circle, Logan Circle, Connecticut Avenue and Capitol Hill.

Abdo is embarking on a conversion at 1220 N St. NW that he says he wouldn't have dreamed of two years ago. The developer, who's made his reputation over the past four years by converting long-neglected properties in Logan Circle, is tackling a 1920s apartment building a block off the circle that's been closed for about 20 years.

Abdo is creating 12 luxury units, selling from the $ 200,000s to the $ 900,000s, with two penthouse apartments. For the penthouses, he is raising the roof to accommodate 20-foot-high ceilings and opening the spaces into New York-style lofts.

Though the street is still considered a gamble by many, Abdo is confident his high-end renovation--with a central elevator that opens to each unit, rooftop terraces and other upscale options--will fly.

"The market's fueled by demand and a shift in the mind-set to a belief that the city is a viable place to live," Abdo said. "I don't see it stopping. How deep is the demand? Nobody has a crystal ball, but there will always be high demand if they're located in the right place and done the right way."

Jonathan Taylor and Michael Rankin, of Tutt, Taylor and Rankin Real Estate, agree. They predict development will follow the commercial and restaurant build-up eastward along K Street and track the Metro in Columbia Heights, as well as out New York Avenue, where another Metro station is proposed.

It's not really possible to count just how many condos are being built or converted from rental properties in the District, though it sometimes seems like they're going up everywhere. While the District has an office of condo and co-op sales and registrations, its two-person staff hasn't been able to both process the wave of applications and do a yearly unit total.

But Linda Harried, head of the office, said she couldn't deny the pace might be setting records. Registration applications from lawyers for developers and tenants, she said, "are coming in like water."

One big tenant conversion is well on its way at 3901 Connecticut Ave. NW, a stately 66-unit building that opened in 1928. The tenants voted in 1998 to hook up with PN Hoffman and partner Keener & Squire when the Chevy Chase Land Co. decided to sell its last property in the District. The tenants paid $ 1 and the developers $ 3.3 million, according to the residents association.

Though the District's tenant-friendly conversion process is considered unbearably cumbersome by many developers--it involves not only getting agreement from half the tenants, but also ensuring accommodations for seniors--the residents had a big incentive for buying: insider discounts.

"We were all happy with the building as a rental property," said Tony Trujillo, president of the tenants association at 3901 Connecticut and now head of the residents association, "but obviously for the younger residents the possibility to buy at below-market prices was very appealing."

According to the developers, the "insider" price for a one-bedroom unit, averaging 750 square feet, was $ 80,000, compared with a market price of $ 175,000. A two-bedroom, averaging 1,450 square feet, sold for $ 157,000, compared with a market price of $ 325,000 to $ 350,000. Three-bedroom units went to insiders for $ 190,000.

Thirty-two residents bought, 17 eligible seniors got to stay on as renters forever, and 17 tenants took buyouts, freeing up units that were sold to outsiders in record time, Squire said.

In some older condo properties, buyers are combining the smaller units created during the last wave of conversions, say real estate agents. Major upgrades in older condo buildings often occur, said Sue Strehlow of Long and Foster's New Mexico Avenue NW office, because the older conversions were "not always the highest quality."

"Now people want what they want and they're willing to pay for it," said Strehlow, who specializes in selling condos.

They still worry about paying too much, however. Michael DiRienzo put a contract on a unit at a new PN Hoffman building at 4025 Connecticut Ave. NW and then canceled "because I thought it might be too expensive."

But then he changed his mind again. "I was up night and day and all I could think about was that someone else would be living in my unit," he said. "Fortunately, it was still available."

It was "a good decision," the 46-year-old said of the $ 203,000 he paid for the unit at Park Hill, which has one bedroom and a den. Not only did he get the new construction he wanted (a choice he acknowledges might seem ironic for a person who works at the National Trust for Historic Preservation) but, for the first time in his life, he got to select every option. "Now when I come home, it's mine," he said.

There's another benefit, he said.

"We know it's already appreciated, because another one-bedroom recently sold for $ 50,000 more than the sales price," DiRienzo said.

CONDO AND CO-OP SALES KEEP UP BLISTERING PACE

* In the District in the dog days of August--and despite what's believed to be record new construction and conversions of rental properties--the number of condo and co-op units available for resale fell to an 11-year low.

At the current rate of sales, there are only enough units to satisfy a month of demand, said trend watchers Fred Kendrick and Peter Clute at Pardoe Real Estate ERA.

Meanwhile, the average price of $ 156,365 is up almost 15 percent from last year, with price tags in particularly coveted neighborhoods going up on the order of 20 percent or more.

* In Montgomery County, a third more condo units sold in August than the year before, but there were only 11 percent more listings, according to Metropolitan Regional Information Systems Inc., the local multiple listings service.

For the first eight months of the year, there were a third fewer listings than in 1999, but 19 percent more settlements. The average price was $ 119,485--down 10 percent from last year. The statistics show very few units priced at more than $ 160,000.

In Prince George's County, listings active at the end of July were down 21 percent from 1999. Year-to-date contracts were up 23 percent.

* In Northern Virginia, almost 4,000 condos were sold during the first eight months of this year, compared with 2,970 a year ago, according to the regional listings service.

And they're generally selling in less than half the time, says real estate company McEnearney Associates. In Tysons Corner, for example, units that stayed around for 65 days last year are now going in 15 days.

The average price remained relatively stable, at $ 118,614, compared with $ 118,266 the previous year, according to the listings service.

* For those curious about the creme de la creme sales: In August, one of seven condos listed for $ 500,000 in Virginia sold; two of four sold in Maryland; and three of 13 sold in the District.

LOAD-DATE: October 07, 2000

Evidentiary Exhibit Number 89

Orlando Sentinel (Florida)

August 20, 2000 Sunday, METRO

SECTION: HOMES; Pg. J21

LENGTH: 682 words

HEADLINE: SMART BUYERS SNAP UP FORECLOSURE DEAL

BYLINE: Robert Bruss,Tribune Media Services

BODY:

QUESTION: Some family members recently lost their home in a foreclosure. How can I buy that foreclosed home for myself? Do home loan lenders usually allow a buyer to take over a foreclosure for the mortgage amount owed on the house,or do lenders want full market value? I know the lender's name but am not sure how much is owed on the foreclosed mortgage. The family members who owned the house will not give me any information. What should I do next?

ANSWER: Most foreclosing lenders who receive title to a foreclosed house will usually list the home at its full, fair market value with a nearby agent if there were no bidders at the foreclosure auction.

However, smart buyers of foreclosed houses immediately contact the foreclosing lender right after the auction to offer the lender the amount of its foreclosed mortgage. I've had good experience sending a Federal Express overnight letter with a purchase offer and a deposit check of at least $5,000 to the lender's president. He or she, of course, never sees my letter, but it will get routed to the lender's REO (real estate owned) representative who can either sell the house or negotiate on price and terms.

If the foreclosed house has not been listed for sale with an agent, it's not too late to contact the foreclosing lender directly. Because you don't know the amount of the foreclosed loan, call the lender's REO department to speak with a sales representative. Most lenders are eager to get rid of their foreclosed houses as fast as possible.

Ask what financing the lender will offer you. I've often bought REO property for only 5 percent to 10 percent down payments and excellent mortgage terms.

DON'T RUSH TO SELL OLD HOME

Q: Last March I received an unexpected job promotion that required us to move. I had to start work in early April, so we didn't have time to sell our home; however, we were able to rent our old house for about $100 per month more than its expenses. We got lucky and found a new house to buy here at a bargain price. If we decide to sell our old house, because it is now a rental and no longer our principal residence, can we still claim that $250,000 home-sale tax exemption?

A: Yes. Internal Revenue Code 121 says that to be eligible for the $250,000 principal residence sale tax exemption, the owner must have owned and occupied it an "aggregate" two years during the past five years before its sale.

Presuming you lived in the house for at least two years and moved out on March 30, converting your former residence into a rental house at that time, you can rent it up to three years -- until March 30, 2003 -- without losing the $250,000 sale exemption, up to $500,000 for a married couple filing jointly.

There is no need to rush to sell the house. If residences are appreciating in that area, you might wish to keep it as a rental for a year or two while it goes up in value before putting it on the market for sale. However, all

depreciation you deduct on your Schedule E rental income tax return will be recaptured and taxed at a special 25 percent federal tax rate at the time of the rental house sale.

SELLERS KNEW? IT'S TOUGH TO PROVE

Q: We bought our home last March. At the time, the seller and agent supplied us with a written disclosure statement. It didn't list any serious defects; however, during a heavy rain shortly after we moved in, the roof leaked over the front hallway near the front door. I mentioned it to my neighbor, and she said our sellers had repaired that leak several times.

We called a roofer who discovered extensive dry rot. The repairs cost us almost $1,100. Do you think we should go after the seller for nondisclosure? The neighbor is willing to testify in court, if necessary.

A: Your difficulty is proving the seller knew of the roof leak and failed to disclose it to you. Perhaps, at the time of the home sale, the seller thought the roof leak had been repaired. If the roof previously leaked but was repaired, the seller need not disclose. Only existing defects must be disclosed to buyers. Please consult a local real estate attorney.

COLUMN: REAL ESTATE MAILBAG

LOAD-DATE: August 20, 2000

Evidentiary Exhibit Number 90

Orlando Sentinel (Florida)
August 6, 2000 Sunday, METRO

SECTION: HOMES; Pg. J22
LENGTH: 704 words

HEADLINE: RENTAL HOMES CAN OFFER GREAT PROFIT POTENTIAL;
IT'S TOUGH TO LOSE MONEY WHEN REAL ESTATE VALUES ARE APPRECIATING AND THE TAX STRUCTURE IS WORKING FOR YOU.
BYLINE: By Robert Bruss
BODY:

A few days ago, I received a phone call from a Business Week magazine reporter who wanted to learn about rental houses and whether they are better investments than the stock market.

Without hesitation, I replied, "Yes."

"Why?" she asked.

"Because rental houses offer far greater long-term appreciation in market value potential than most stocks," I replied. She couldn't believe it.

Then I explained why experienced rental house investors buy properties that are likely to go up in market value. I politely emphasized the stock market appreciates, on average, about 11 percent each year. However, thanks to the "magic of leverage," smart rental house investors won't purchase unless they can see at least a 20 to 30 percent annual return on their invested dollars.

In addition, I said, "Don't forget the depreciation tax deductions to shelter the rental income from taxation." Then I explained why depreciation is the best tax deduction of all because it is a noncash deduction for estimated wear, tear and obsolescence on the rental property. I believe I lost her on that benefit.

For most of us, our best investment has been our principal residence. Then why not own several? Because you can't live in all your houses, it pays to rent some to tenants. That way you'll benefit from the probable market value appreciation of both your primary home and rental houses. Meanwhile, your tenants "buy" your rental houses for you. Aren't they nice?

For example, in 1983 I bought an empty, boarded-up "drug house" from the savings and loan that took it back when nobody bid at its foreclosure sale. I paid $95,000 with a $9,500 down payment. Fix-up costs (all hired) were less than $5,000. Last year I sold that house for $250,000 net cash. In addition to my $150,000 net profit, I sheltered all my rental income, plus some of my ordinary income, through depreciation tax savings.

Whatever my annual return on my $14,500 initial total investment from that rental house, it's good enough. Where else could I have earned such an excellent return?

Next, I explained to the savvy reporter how to look for fixer-upper houses in need of cosmetic improvements. I believe it was the late, great Bill Nickerson, author of How I Turned $1,000 Into $10 Million in My Spare Time who coined that phrase. Avoid the "red ribbon deal" houses in model-home condition because they offer little profit potential. That's the way to sell, not buy, profitable houses.

Next, I shared how buying sound, well-located houses with "the right things wrong" creates "forced inflation" profits for the investor. She liked that term. I explained how profitable improvements such as paint (the most profitable improvement of all), new carpeting, new light fixtures, fresh landscaping, cleaning and repairing can add value to force the home's value up.

Finally, I emphasized unprofitable improvements to avoid. These are defined as necessary repairs or improvements that don't add as much market value as they cost. Examples include a bad foundation, a new roof (although sometimes it is absolutely necessary), an additional bedroom, a family room or a swimming pool. She instantly related to that one because she wouldn't want to own a house with a swimming pool.

I believe I lost the reporter when I launched into the next rental house advantage: tax-free refinancing. Every few years, I pointed out, many rental house investors like me refinance their mortgages to take out tax-free cash from the home's rising equity.

Because the tenant rents are used to make the mortgage payments, it is the tenants who are buying the house for the investor.

After our phone conversation, I kicked myself for failing to mention how rental house investors who eventually decide to sell can claim up to $250,000 (up to $500,000 for a married couple filing jointly) tax-free home-sale profits.

All it requires is for the owner to move into the rental house an aggregate two out of the past five years before its sale. The tax result is converting the house into a personal residence eligible for the $250,000/$500,000 principal residence sale exemption. In fact, this tax exemption can be used over and over by "serial home sellers" once every 24 months.

COLUMN: REAL ESTATE NOTEBOOK

LOAD-DATE: August 6, 2000

Evidentiary Exhibit Number 91

The San Diego Union-Tribune

July 30, 2000, Sunday

SECTION: REAL ESTATE;Pg. H-3

LENGTH: 840 words

HEADLINE: Here's why real estate is a better investment than the stock market

BYLINE: ROBERT J. BRUSS; Robert J. Bruss is a San Francisco lawyer, broker and nationally syndicated real estate writer. | (C) Tribune Media Services

BODY:

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"Why?" she asked.

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However, thanks to the "magic of leverage," smart rental house investors won't purchase unless they can see at least a 20 percent to 30 percent annual return on their invested dollars.

In addition, I remarked, "Don't forget the depreciation tax deductions to shelter the rental income from taxation." Then I explained why depreciation is the best tax deduction of all since it is a noncash deduction for estimated wear, tear and obsolescence on the rental property. I think I lost her on that benefit.

For most of us, our best investment has been our principal residence. Then why not own several? Since you can't live in all your houses, it pays to rent some to tenants. That way you'll benefit from the probable market value appreciation of both your primary home and rental houses. Meanwhile, your tenants "buy" your rental houses for you. Aren't they nice?

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Last year I sold that house for $250,000 net cash. In addition to my $150,000 net profit, I sheltered all my rental income, plus some of my ordinary income from writing these columns, through depreciation tax savings.

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The small things

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If owning your primary residence has proven to be a good investment, why not own several more? Look for sound, well-located houses that need cosmetic improvements, such as painting, landscaping, cleaning, repairing and new carpeting. New light fixtures are especially profitable.

When possible, buy with low down payment seller financing, thus saving on finance costs. Then either hold the rental house as a long-term investment (with periodic tax-free refinancing to take out cash for more investments) or become a serial home seller and sell the rental house, after occupying it at least 24 months, free of capital gain tax up to $250,000 per qualified owner.
LOAD-DATE: July 31, 2000

Evidentiary Exhibit Number 92

Chicago Tribune

July 29, 2000 Saturday, CHICAGOLAND FINAL EDITION

SECTION: New Homes; Pg. 17; ZONE: W; Realty Q&A.

LENGTH: 840 words

HEADLINE: SURPRISE BONUS;

WHEN $250,000 HOME-SALE TAX BREAK IS AVAILABLE FOR RENTAL HOUSE

BYLINE: By Robert J. Bruss, Tribune Media Services.

BODY:

Q--Last March I received an unexpected job promotion that required our moving. I had to start work in early April, so we didn't have time to sell our home; however, we were able to rent our old house for about $100 per month more than its expenses. We got lucky and found a new house to buy here at a bargain price. If we decide to sell our old house, since it is now a rental and no longer our principal residence, can we still claim that $250,000 home-sale tax exemption you often discuss?

A--Yes. Internal Revenue Code 121 says that to be eligible for the $250,000 principal residence sale tax exemption, the owner must have owned and occupied it an "aggregate" two years during the past five years before its sale.

Presuming you lived in the house for at least two years and moved out on March 30, 2000, converting your former residence into a rental house at that time, you can rent it up to three years --until March 30, 2003--without losing the $250,000 sale exemption, up to $500,000 for a married couple filing jointly.

There is no need to rush to sell the house. If residences are appreciating in that area, you might wish to keep it as a rental for a year or two while it goes up in value before putting it on the market for sale. However, all depreciation you deduct on your Schedule E rental income tax return will be recaptured and taxed at a special 25-percent federal tax rate at the time of the rental house sale. For further details, please consult your tax adviser.

Q--We have accumulated considerable credit card and other debt. As a result, we somehow got on the mailing lists of several mortgage lenders. They are eager to refinance our home loan with a new mortgage up to 125 percent of our home's appraised market value, but they want 12.5-percent interest, plus various fees. They tell us that our debt will then become tax deductible as home mortgage interest since our credit card interest is not tax deductible. What do you think of this idea?

A--You are being misled by those mortgage salespersons. The Internal Revenue Code only allows home mortgage interest deduction on loans secured by your residence up to its market value, but not exceeding it, with a $1 million maximum deductible home mortgage.

In other words, interest on your home loan exceeding the residence's market value will not be tax deductible. I am also concerned about that high 12-percent interest rate. Unless you have bad credit, you can probably refinance your home loan for around 8 percent and then obtain a home equity loan up to 80, 90 or even 100 percent of your home's value at around the prime rate.

Please shop among at least six mortgage lenders. You are to be commended for wanting to pay off your high-cost credit card debt, but a 125-percent home loan might not be the best way to do so.

Q--My husband's construction business went bankrupt several years ago. He owed large amounts of money to workers. Is there a specified time after which these debts are no longer effective? We want to buy a home but hesitate because we're afraid these debts will attach to our home.

A--You should consult the attorney who handled the bankruptcy. If it was a Chapter 7 liquidation of the business and your husband had no personal liability, those debts were probably discharged, unless fraud was involved and your husband has continuing personal liability.

Personal bankruptcy usually stays on your credit report for 10 years; however, if you can re-establish credit, some lenders will make home mortgage loans within two years after bankruptcy discharge. Before shopping for a home, you and your husband should get preapproved for a mortgage so you are certain the bankruptcy won't prevent you from buying a home.

Q-- I own a small property that I want to give to my son as a gift. What type of papers do I need, and where can I get them? I am 79.

A--If the property has no mortgage and no lender is involved, you can sign a quit claim deed to your son. A real estate attorney can prepare the deed, including the legal description and, in most states, the assessor's tax-parcel number so it meets legal requirements for recording. Of course, your signature as the grantor must be notarized.

In addition, if the property equity is greater than $10,000, you are required to file a gift tax declaration with the Internal Revenue Service. If you have given away less than $675,000 of assets during your lifetime, no gift tax will be due under the federal combined estate and gift tax exemption.

Your son may want to purchase an owner's title insurance policy to be certain he is obtaining marketable title. The attorney preparing the quit claim deed can arrange title insurance. As you can see, giving away real estate correctly is not a simple matter.

PLEASE NOTE: Real estate laws vary from place to place. Be sure to check the laws of your state and municipality before making decisions on real estate matters.

Write to Robert Bruss at Tribune Media Services, 435 N. Michigan Ave., Chicago, IL 60611.
LOAD-DATE: July 29, 2000

Evidentiary Exhibit Number 93

International Money Marketing

July, 2000

SECTION: Pg. 20

LENGTH: 2987 words

HEADLINE: Case Study Mr X

BODY:

Age: 42

Status: Married, no children

Family income: Mr. X earns circa GBP 50,000 pa and his wife earns GBP 20,000

Employed: Civil engineer, so far mainly in contract work

Home ownership status: A 25-year endowment mortgage on a GBP 65,000 semi- detached, two-bedroomed house in North Yorkshire ten years ago. He put down a GBP 5,000 deposit.

Changing circumstances: He is leaving to work in Spain, probably for a number of years and is considering buying a second home there. His wife also has a job in Spain, though her income will be less than what she earned in the UK (GBP 15,000).

Investments: GBP 30,000, in cash and securities

So, what should Mr X do with the property he owns in Yorkshire? Should he consider a Euro mortgage or a Sterling one? Why would an international offshore mortgage be (or not be) a viable option under these circumstances?

Choosing a loan based on rental income

Mr X is likely to have built up significant equity in his North Yorkshire property. It would be a mistake to get rid of it for a number of reasons. First, if Mr X's contract in Spain ends or he returns to the UK, he will need a home. Second, nobody can predict what will happen to the UK property market and it may be wise to retain a UK property; that way, if prices increase significantly, Mr X will have kept pace with the change. Third, Mr X could rent out his house and use the rent as a source of income and build up sterling-based savings, which will be useful if he is being paid in euros.

While he could take out a residential mortgage with an offshore provider, it may be more beneficial for him to take out one of the buy- to-let mortgages designed for expats to buy UK property. These loans are generally based on the potential rental income rather than on personal income, which should make it easier for Mr X if he wants to buy a property in Spain. He could expect to see a yield of between five and ten per cent, but would need to ensure that he has a good agent to look after the property in his absence.

Mr X should take out this mortgage in sterling, especially as he will be repaying it with sterling rental income. He can also consider an offshore residential mortgage, denominated in euros, to buy his house in Spain. He could look for property between E150,000 and E200,000 (or peseta equivalent). This way, he can borrow in the currency he is being paid in: this will avoid the danger of repayments becoming unmanageable because of currency fluctuations. Both sterling and euro mortgages have specific benefits. Euro mortgage rates are

generally lower than sterling rates, while sterling would give him a good secure base of a matched sterling account.

By building a relationship with an offshore lender early on, Mr X will be in a good position to manage changes in his circumstances. Offshore lenders are specialists in the needs of expats and in managing the complex affairs of mobile business people. Mr X will also need to consider the effect of currency fluctuations on his savings, and a relationship with an offshore financial institution would give him access to expert advice on how to manage his savings.

Match a mortgage with the country's currency

Most mortgage borrowers do not want to add additional risks to their mortgage by speculating on the foreign currency markets, and the way to minimise risk is to borrow in the currency of the country where the property is situated.

The basic rule is that if you match the asset (the property) and the liability (the mortgage), you are reducing exposure to currency movements as much as possible. Therefore, Mr X's mortgage on his Yorkshire property should remain in sterling, and if he decides to buy a property in Spain the mortgage on that property should be in euros.

The maximum mortgage normally available in Spain is 75 per cent of property value, and the associated purchase expenses will be significantly higher than in the UK. If his GBP 30,000 savings isn't sufficient to cover the deposit and purchase costs, he might well have sufficient equity in his Yorkshire property to raise the additional funds required by way of a further advance or remortgage.

Some UK lenders will load the interest rate when a property is being let, whereas others will allow borrowers to continue on the same rate. Therefore, whether Mr X stays with his existing lender or remortgages will depend to a considerable degree on his lender's policy on this.

If the Yorkshire property is let out, the rent, which would be received in sterling, will probably cover most or all of the mortgage payments. Mr & Mrs X's income in Spain will presumably be received in pesetas, and this would be used to pay the mortgage on the Spanish property.

Although the income to support each mortgage will be received in the currency in which that particular mortgage is denominated, this is, in my view, relatively unimportant in deciding which currency to choose for the mortgage. With interest rates in both sterling and euros being low, the risks of a currency mismatch between the asset and the liability are far greater than the risks that can arise from mismatching the income and liability.

Because the European Central Bank Base Rate is 1.75 per cent lower than the Bank of England Base Rate, there is a common misconception that the interest rate on a euro mortgage will be lower than the rate on a sterling mortgage.

The reality is that because the UK mortgage market is so much more sophisticated and competitive than the market in other European countries, the difference in the interest rates actually charged on comparable competitive mortgages is very small. Therefore, interest rate differences are not a factor when deciding in which currency to borrow.

It is difficult to comment in any detail as to whether there would be any benefit in switching the UK property he currently owns to an offshore mortgage, because a lot more information would be required about Mr X's tax status in order to consider this properly.

However, if he lets out the property and, assuming the rent is paid in the UK, he is unlikely to be liable to much, if any, UK tax. This is because the mortgage interest payable, and the other property related expenses incurred - such as agents fees - can be offset against the rent.

If he switched to an offshore mortgage he would probably not be able to get as competitive an interest rate and, therefore, could actually find himself worse off. However, I would personally always advise a client who is in this situation to seek advice from an accountant who is familiar with tax matters concerning expatriates.

Ray Boulger is senior technical manager at John Charcol, the independent mortgage financial adviser

Contract workers have limited opportunities

I could not help Mr X with a mortgage in Spain or the UK, because:

The lenders we deal with in Spain cannot assist clients on contract work, unless three year's audited accounts are available. You also say he has 'mainly' been on contract work, but not totally, therefore not showing any long-term record. It is worth pointing out that the underwriting criteria in Spain is much stricter than in the UK, and non- status/self-certification schemes are not currently available in Spain via our lenders.

Spanish lenders require him to have been in his new occupation for at least six months. The same applies to his wife

Without knowing the current value of his UK property, I cannot advise whether any monies can be raised on this property.

As it is unclear whether he and his wife will enjoy being in Spain, I would strongly advise he keeps his UK property and only rent in Spain for at least the first year

If he rents the UK property, there are not many lenders who will lend in euros (unless he is earning in euros) It would be advisable to only borrow in sterling in the UK, as the rental income would likely to be also in sterling

I cannot comment in offshore mortgages, as I do not know the value of the property; many lenders will not look at an offshore mortgage unless the property is valued over GBP 150,000

Simon Conn is proprietor and licensed credit broker at Conti Financial Services.

Plan the mortgage before finding the house

It would be useful for Mr and Mrs X to work out the value and price of the property in Spain they wish to buy, along with an indication of the likely amount they would need to borrow - even at the early stages. We encourage clients to contact their chosen lender, even before they find a property. This way, they can have a 'decision in principle', which will assist greatly in knowing what they can comfortably afford to buy and what finance is available.

Mr X and his wife have owned a property for ten years in the UK, which indicates a degree of stability and works in their favour. The liability they have (on the mortgage of their property in Yorkshire) will be taken into account within our calculations.

As far as their employment is concerned, Mr X has clearly been employed in the UK, and he will need to provide evidence of continuity of employment over the previous three years. Mrs X has secured employment in Spain, which is positive, and Mr X who has planned work in Spain will need to show evidence of what his intentions are for employment, showing the level of his expected salary.

Where available cash and investments are concerned, it is useful that they have GBP 30,000 as it could assist towards the purchase of the Spanish property, be used as an asset and help in the decision-making process. With regards to their UK property, it is the client's choice as to whether this could be viewed as an asset, perhaps to retain and rent for additional income or to sell to provide further funds for their foreign purchase.

A range of mortgages are available, but customers need to think carefully about the currency in which they wish to take out their mortgage, and they should consider the currency fluctuations during what will be a long-term commitment. So, we advise they budget carefully and consider this with their choice of mortgage.

A logical and viable option for clients wishing to purchase for reasons similar to that of Mr and Mrs X is the offshore product, which is geared specifically for the expatriate market.

Sally Butcher is a mortgage adviser at Abbey National Gibraltar.

Principal concern is currency

To make the most of this opportunity, Mr X needs to consider two areas. First is his UK property. He might need to sell if he does not have a sufficient deposit for his new Spanish property. However Mr X should keep the property if he is concerned about:

The UK property market rising

Keeping a place he can return to

The sale of the property will be free of CGT if it is his principal private residence. The endowment policy becomes superfluous if the property is sold. This could be auctioned to raise any further funds which might be useful now, but keeping the policy provides a good savings discipline and he might benefit from a windfall if the life office is one about to demutualise.

Alternatively, Mr X might be concerned about his job security in Spain and what to do if he is suddenly out of work. Keeping the UK house available will provide that security and does not cause any complications with Mr X's changing tax position.

Finally, many expats prefer to let their properties and, hopefully, the rent Mr X will receive - minus the usual letting expenses - will cover the cost of the mortgage.

Mr X can calculate the likely rent, compare it with outgoings and perhaps reduce his mortgage, though that might not leave enough for his Spanish property acquisition. Rental income is potentially chargeable to UK tax, even though Mr X is outside the UK.

He might consider renting a property until he is settled in his job, then he can be more likely to make a sound long-term choice. Clearly, if he buys he will need to raise mortgage finance, but the good news is that there are a number of specialist UK lenders who will provide finance in Spain, as well as local banks. So, Mr X can expect to select between competitive terms and rates.

His principal concern will be currency. He will, no doubt, be paid in Spanish pesetas, and as that currency already has a fixed exchange rate against the euro Mr X should take out a euro or peseta mortgage. That way he matches the currency of his liabilities to his income. The property will also be valued in pesetas, increasing his currency security.

Luckily for Mr X euro interest rates are lower than sterling rates so he will be paying less. At present, sterling remains strong against the euro, and where Mr X needs to raise a deposit he should transfer from his present cash and securities to secure this rate. Looking ahead, Mr X does run a risk that if he keeps his Spanish

property and sterling appreciates further he might 'lose out' - in sterling terms. But equally, the euro could well strengthen, in which case he will be a sterling winner!

Check with the taxman in Spain

There are many factors Mr X must consider before he takes any action. The first is whether he wishes to keep the UK property or not. If he decides to sell, he must consider the following factors.

As the existing mortgage is endowment-linked, there should be a value in the endowment. Should Mr X cash this in, he may wish to consider the advantages of the many offshore savings products available to expatriates. This decision will, to an extent, depend on how long Mr X plans on living abroad and for how long he will be able to take advantage of his expatriate status. It will also depend on how long his endowment has been running; the shorter the time, the less money will have accrued because of the upfront charges.

It may be prudent for Mr X to continue the endowment policy to use against another mortgage in the UK should he return to live there, or as a savings vehicle. If Mr. X's existing mortgage was on a fixed rate, the repayment may give rise to an early repayment fee. He should check this with his lender. If he decides to keep the property and let it out, he needs to:

Check that the current lender consents to letting and that the lender will not increase the interest rate as Mr X is now not resident in the UK. If the rate rises, Mr X can always consider switching to another lender who will provide a better deal

Consider using an agent to find tenants and manage the property on his behalf

Inform the buildings insurer that the property will be rented, which can affect the premiums

Mr X should register with the Inland Revenue as a non-resident landlord. UK rental income is liable to UK tax but, depending on the level of income and general mortgage costs, as well as personal allowances, tax may not arise. Not all cases will be the same. He should see whether the tax authorities in Spain will also tax UK income, as this may affect the decision to let. Another tax factor to consider is any potential capital gains tax implications on the sale of the UK property. Mr X could be free of UK capital gains tax, but would have to look at the possibility of Spanish capital gains tax.

Mr X could transfer the mortgage to euros. However, there are a limited number of providers who offer this service at present, and as rental income will be in sterling, he will open himself up to a currency risk. With his change of circumstances, we would suggest that Mr X consult an IFA for a full financial planning check.

If buying a Spanish property, it is appropriate to source a lender in Spain, as not many non-Spanish banks will provide for a property in another country.

Let out your existing property

When Mr X moves to Spain, his first consideration is what to do with his existing property. He should certainly consider letting it out while he is away.

However, if he has problems letting his existing property, then we would suggest that, unless the property or area has strong sentimental attachment, he should sell up and buy a property in a different part of the UK. This would enable him to retain an interest in the UK property market.

Once Mr X moves to Spain, it will make sense for him to rent a property. Unless he happens to be moving to an area where there is particular capital appreciation on residential properties, the duration of his stay is unlikely to make buying financially viable.

Mr X might want to buy a house that he could use as a holiday home after he returned to the UK. In this instance, he could consider gearing up on the equity in his existing home. We, for example, would be willing to lend him 70 per cent of the overall value of his existing property as an equity release loan at mortgage rate.

If Mr X does decide to buy and requires a mortgage, the type he takes out should depend on how he intends to repay it. If he can cover the mortgage repayments from the rental income from his existing property, he should probably get a sterling mortgage.

Alternatively, if he is dependent on his salary for repayments, he should consider a euro mortgage. He is likely to be paid, or could be paid, in euros, so if his mortgage is in euros there is no exchange risk. Mr X will also get a lower interest rate if he borrows in euros. Whether his mortgage should be taken out offshore is a difficult question without knowing full details of Mr X's tax situation. We would advise Mr X to see his tax adviser in the first instance.

Generally, Mr X should have an offshore account while in Spain to maximise his tax status. So if he has an onshore mortgage and has to re- admit funds onshore to service it, that would be a constructive remittance and he would be taxed on it. Thus, in most cases we would advise he keep his mortgage offshore, but he would need to take specialist tax advice on that.

LOAD-DATE: September 1, 2000

Evidentiary Exhibit Number 94

The Record (New Jersey)
June 30, 2000, Friday

KR-ACC-NO: HK-HOME
LENGTH: 658 words
HEADLINE: Hackensack, N.J.-Area Retirees Consider Surroundings, Cost to Relocate
BYLINE: By Kathleen Lynn
BODY:

Marianne and Anthony Orecchio of Haworth used to think about moving out of North Jersey when they retired.

"Our plan was to move somewhere where it's cheaper to live, and do some traveling," said Marianne Orecchio, 64, whose three children live in Bergen County.

"We chose not to do that because my husband became ill. That's when we found out how important it is to stay put, with friends and family around and [medical] services you're familiar with."

Like the Orecchios, 85 percent of American seniors stay where they are as they age.

But the cost of living is high in North Jersey, the winters cold. Some seniors are tempted by areas where housing costs and property taxes are much lower, such as Florida, North Carolina, and South Jersey. And retirement communities can offer a lot of activities and socializing that seniors might not find in a suburban neighborhood, surrounded by younger families.

"It's a pretty neat world out there," said one North Jersey man who is looking at a Cape Cod retirement. (He asked not to be identified because his employer doesn't know he's thinking of retiring.)

Before choosing to move, experts say seniors should do some research. Does the new area offer entertainment, recreation, and good hospitals? A number of books rate different areas as places to live. If possible, they should vacation in the area they're considering. It's also wise to rent first, rather than buy, in case the move is disappointing.

Although this is primarily a social and emotional decision, the financial elements can make a difference. Moving out of this high-cost area can certainly save money. Consider:

An existing single-family home in Bergen or Passaic county costs a median $ 250,000. A senior citizen who sells a house here and wants to move south can get a house in Winston-Salem, N.C., for a median $ 125,000; in Fort Lauderdale, Fla., for $ 140,000.

New Jersey's property taxes are the highest in the nation, at $ 1,606 per person. By contrast, local property taxes in North Carolina are $ 475 per capita; in Florida, $ 773.

Auto insurance in New Jersey is among the highest in the nation, an average premium of $ 988.

If you decide to sell your home in North Jersey, you may have large capital gains. But thanks to recent changes in the tax laws, homeowners can avoid taxes on $ 250,000 ($ 500,000 for a married couple) in capital gains on a house sale.

If you want to have two homes -- one in the North for the summer and one in the South for the winter -- mortgage interest is deductible on both, up to a total of $ 1 million.

Rather than move out of the area, some people want to sell the big house and rent an apartment nearby. Because rents are so high in northern New Jersey -- $ 1,000 or more is common for a one-bedroom -- your monthly costs may not go down much, but you will convert your house's value into cash for living expenses.

Another choice is moving to a smaller, one-story house to save on costs and on trips up and down the stairs.

If you sell the house and buy into a new adult community, you may end up spending almost as much on housing costs. For example, at K. Hovnanian's Four Seasons adult community in Wayne, prices start at $ 230,000.

If you think you might need federally subsidized senior housing, where rent is fixed at 30 percent of your income, get on the waiting list at municipal or county housing authorities.

Waiting lists can be as long as three to five years, said Jack D'Ambrosio, executive director of the Bergen County Housing Authority. So he warns seniors not to wait for a crisis -- a sudden illness, the death of a spouse, a drop in income.

"Things can change overnight," he said. "Think ahead. You've heard of preventive medicine. Consider this preventive housing."

JOURNAL-CODE: HK
LOAD-DATE: July 1, 2000

Evidentiary Exhibit Number 95

Chicago Tribune

June 24, 2000 Saturday, CHICAGOLAND FINAL EDITION

SECTION: New Homes; Pg. 24; ZONE: W; Realty Q&A.

LENGTH: 1299 words

HEADLINE: NEVER TOO LATE;

CONCEPT OF WAITING FOR A BETTER PRICE ON A HOME WON'T WASH

BYLINE: By Robert J. Bruss, Tribune Media Services.

BODY:

Q - I know we waited too long to buy a home. My husband thought mortgage interest rates would come back down to around 7 percent. Instead, they went up to around 8.5 percent for a fixed-rate mortgage. We have a nice apartment at a fair rent, but our daughter is now 3, and she needs a yard for play. Do you think we should wait until interest rates decline before we buy a home?

A - No. There is no indication that mortgage interest rates will decline any time soon. Alan Greenspan thinks raising interest rates will prevent inflation, and he has no plans to reduce interest rates. If you wait to buy a home, you will lose out on the home ownership benefits.

Buy a home now, especially because the sales volume is slowing and sellers are becoming more reasonable with their asking prices. If you can get an adjustable rate mortgage with the interest rate locked in for three, five or even seven years, that could be a good deal. Just be sure it doesn't have a prepayment penalty. If interest rates plummet, you can then refinance. If they don't drop, you have a bargain mortgage.

Q - Some time ago you recommended home buyers obtain a professional home inspection. Should this be done before or after making a purchase offer?

A - After. Your written home purchase offer should contain a contingency clause for a professional home inspection.

After the seller accepts your purchase offer, be sure to accompany the professional inspector you hire, even if you must take time off from work. He or she will explain any defects discovered and the approximate repair cost.

Then you can take the inspector's written report to the seller to obtain a credit for any serious defects discovered. But don't nitpick and lose a desirable home over a few minor defects.

Q - About six years ago, my wife and I bought a townhouse in Naples, Fla., where we spend five or six months every year. We recently received an unsolicited offer from a neighbor's friend, who wants to buy it. We are tempted to accept; however, we are concerned about that new $250,000/$500,000 home-sale tax exemption. What kind of proof will Uncle Sam require from us to demonstrate it was our "main home" for the "aggregate" 24 months during the 60 months before the sale?

A - So far, no U.S. Tax Court decisions have involved the new Internal Revenue Code 121 principal residence $250,000 tax exemption, $500,000 for a married couple filing jointly, which became law in 1997. The statute does not specify what information proves the residence was your "main home" or principal residence.

In what I think was a stupid move, in 1998 the IRS abolished IRS Form 2119 for reporting the sale of a principal residence. Now, if you sell your Naples home, which you think qualifies for the $250,000/$500,000

tax exemption, you don't even have to report the sale on your income tax returns. Only taxable principal residence sales are now reported on Schedule D with other capital gains.

. My suggestion is to retain all records, especially utility bills, to prove the residence sold was your primary residence during the months you lived there.

Q - Homes are selling like hotcakes in our neighborhood. Regrettably, we must sell ours due to a job transfer. We've interviewed two Realtors so far. Both recommend we include a one-year home warranty as a sales inducement, even though it will cost us about $350. With homes selling so well in our neighborhood, don't you think we should save the $350?

A - No. Listen to those smart real estate agents. One-year home warranties are a great idea for both sellers and buyers. They help prevent future disputes, such as when the dishwasher leaks the day after the sale closes and the buyer blames you for concealing the problem.

Although one-year home warranties on resale houses only include items such as wiring, plumbing, furnace, built-in appliances and the water heater, they give prospective buyers assurance. For an additional premium, buyers can usually insure the roof, air conditioning, swimming pool, plumbing outside the home's perimeter and other components.

Q - A few weeks ago you ran an item from a home buyer who obtained 100-percent financing with an 80-percent mortgage and a 20-percent home equity loan from the same lender. Which lender is that?

A - Virtually every home loan lender now offers 97-percent Fannie Mae and Freddie Mac mortgages. In addition, several nationwide lenders offer 100-percent home loan financing in almost every state. Most local mortgage brokers can often arrange 100-percent home purchase financing, too.

From experience, I've learned that once I start naming lender names, I get swamped with ugly mail from other lenders who offer similar loan programs and demand equal space. Just start dialing for dollars. Check your phone book yellow pages under "real estate loans" to find the local 100-percent lenders.

Q - Last March I received an unexpected job promotion that required our moving. I had to start work in early April, so we didn't have time to sell our home; however, we were able to rent our old house for about $100 per month more than its expenses. We got lucky and found a new house to buy here at a bargain price. If we decide to sell our old house, since it is now a rental and no longer our principal residence, can we still claim that $250,000 home-sale tax exemption you often discuss?

A - Yes. Internal Revenue Code 121 says that to be eligible for the $250,000 principal residence sale tax exemption, the owner must have owned and occupied it an "aggregate" two years during the past five years before its sale.

Presuming you lived in the house for at least two years and moved out on March 30, 2000, converting your former residence into a rental house at that time, you can rent it up to three years -- until March 30, 2003 -- without losing the $250,000 sale exemption, up to $500,000 for a married couple filing jointly.

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Write to Robert Bruss at Tribune Media Services, 435 N. Michigan Ave., Chicago, Ill. 60611

LOAD-DATE: June 24, 2000

Evidentiary Exhibit Number 96

South Bend Tribune (Indiana)

June 17, 2000, Saturday INDIANA, MICHIGAN, MISHAWAKA, PHM, TRIBUNE

SECTION: HOME, Pg. c4

LENGTH: 472 words

HEADLINE: Home-sale tax break available for rental house

REAL ESTATE NOTEBOOK

BYLINE: ROBERT L. BRUSS;

BODY: Q. Last March I received an unexpected job promotion that required our moving. I had to start work in early April, so we didn't have time to sell our home; however, we were able to rent our old house for about $100 per month more than its expenses. We got lucky and found a new house to buy here at a bargain price. If we decide to sell our old house, since it is now a rental and no longer our principal residence, can we still claim that $250,000 home-sale tax exemption you often discuss?

A.Yes. Internal Revenue Code 121 says that to be eligible for the $250,000 principal residence sale tax exemption, the owner must have owned and occupied it an "aggregate" two years during the past five years before its sale.

Presuming you lived in the house for at least two years and moved out March 30, converting your former residence into a rental house at that time, you can rent it up to three years--until March 30, 2003--without losing the $250,000 sale exemption, up to $500,000 for a married couple filing jointly.

There is no need to rush to sell the house. If residences are appreciating in that area, you might wish to keep it as a rental for a year or two while it goes up in value before putting it on the market for sale. However, all depreciation you deduct on your Schedule E rental income tax return will be recaptured and taxed at a special 25-percent federal tax rate at the time of the rental house sale. For further details, please consult your tax adviser.

Q. We have accumulated considerable credit card and other debt. As a result, we somehow got on the mailing lists of several mortgage lenders. They are eager to refinance our home loan with a new mortgage up to 125 percent of our home's appraised market value, but they want 12.5-percent interest, plus various fees. They tell us that our debt will then become tax deductible as home mortgage interest since our credit card interest is not tax deductible. What do you think of this idea?

A.You are being misled by those mortgage salespeople. The Internal Revenue Code only allows home mortgage interest deduction on loans secured by your residence up to its market value, but not exceeding it, with a $1 million maximum deductible home mortgage.

In other words, interest on your home loan exceeding the residence's market value will not be tax deductible. I also am concerned about that high 12.5 percent interest rate. Unless you have bad credit, you can probably refinance your home loan for around 8 percent and then obtain a home equity loan up to 80 percent or even 100 percent of your home's value at near the prime rate.

Please shop at least six mortgage lenders. You are to be commended for wanting to pay off your high-cost credit card debt, but a 125 percent home loan might not be the best way to do so.

LOAD-DATE: June 22, 2000

Evidentiary Exhibit Number 97

Orlando Sentinel (Florida)
June 3, 2000 Saturday, METRO

SECTION: HOMES; Pg. G10
LENGTH: 579 words

HEADLINE: NEW HOMEOWNER GETS RAINED ON

BYLINE: Robert Bruss,Tribune Media Services

BODY:

QUESTION: We bought our home last year. The seller and realty agent gave us a disclosure form that said nothing major was wrong with the house. Everything went well for a few months after we bought. Then we had a heavy rain, and the roof leaked badly.

We contacted the realty agent, and she said it was the seller's responsibility to disclose any roof leaks. But the seller has moved out of state with no forwarding address. We knew the roof was at least 15 years old; however, we didn't anticipate having to pay $14,500 for a new roof so soon.

Do we have any recourse against the realty agent? What about the inspector we hired whose inspection report says only "The roof appears to be older. A roof inspector should be contacted."

ANSWER: If you want the seller or realty agent to help pay for your new roof, your legal difficulty is proving the seller and-or the real estate agent knew the roof leaked before the sale. Maybe it just started leaking during that heavy rain. Evidence of prior leaks, such as ceiling water stains, might be the proof you need.

It appears your professional inspector protected himself by stating the roof was "older" and that you should contact a roof inspector. However, if there is attic access where water stains are obvious, your inspector should have informed you.

Although it is possible to serve an out-of-state defendant by publication in a local legal newspaper, court approval is usually required. An alternative is to file a homeowners insurance claim. If the rain was wind-driven, all or part of your roof replacement might be covered by your insurance.

RENT, BUY, RENT, BUY?

Q: My husband and I will be relocating for about three years. We are trying to decide if we should sell our home or lease it while we're gone. To compete with other rentals, the rent we can charge will cover only our mortgage payment, property taxes, homeowners association fees and insurance.

Would renting our home be a smart financial move? If we sell today, we won't have any taxable profit because of the $250,000 home-sale exemption. What tax breaks can we take as investment property owners?

A: The question to ask yourselves is whether your home will be worth more in three years. Because your letter comes from a highly desirable area, the only direction your home value will probably go is up during the next three years.

Another question to ask is if you sell your home today and take your tax-free profit, will you be able to buy back into the same housing market in three years? I think you know the answer is no.

Normally, I do not recommend long-distance rentals; however, because you plan to return to the same area in three years, I strongly suggest you do not sell today. Renting for three years, even if you break even, could be an excellent decision.

While renting you can deduct mortgage interest, property taxes, insurance, homeowner association dues, maintenance and other out-of-pocket expenses from the rent received. In addition, you can deduct depreciation. That is a noncash tax deduction for estimated wear, tear and obsolescence.

The net result should be a tax loss, thanks to the depreciation deduction. If you have adjusted gross income of less than $100,000, you can deduct up to $25,000 per year of so-called "passive activity" losses from your rental property against your taxable ordinary income. The result should be tax savings, thanks to your rental property, which is probably appreciating.

COLUMN: REAL ESTATE MAILBAG

LOAD-DATE: June 3, 2000

Evidentiary Exhibit Number 98

Fort Collins Coloradoan
May 28, 2000 Sunday

SECTION: REAL ESTATE; Dave Pettigrew; Pg. 2F
LENGTH: 708 words
HEADLINE: Many variables weigh in on 'buy first, sell first' quandary
BYLINE: Freelance
BODY:

If you are considering the sale of your present home and the purchase of another, you are probably caught up in the "do I buy first or sell first" dilemma.

Of course, the ideal scenario would be to buy and sell simultaneously. But such timing is never guaranteed.

The easiest way is to find a home you want and make an offer contingent upon the sale of your present home.

But in this market, it is more and more difficult to get a seller to accept a contract with this contingency and if you are able to get your offer accepted, the home you want to purchase would probably remain on the market and you are in danger of being "bumped."

To avoid being bumped, you will usually have 48 or 72 hours to remove this contingency and to provide proof from a lender that you are able to close the purchase without the sale of your present home.

Prior to making this contingent offer, you will need to know what the market value of your present home, the selling costs, payoffs and how much equity is available to you. You should also be pre-qualified or pre-approved for the purchase price and financing of the new home.

To remove the contingency, many people use their home equity line of credit as a "bridge" or "swing" loan to provide the new down payment. However, to qualify, homeowners generally need a sizeable income. Even if you qualify, the stress of owing on three mortgages - the old mortgage, the bridge loan and the new home mortgage - might force you to sell your home at a price lower than you hoped.

Keep in mind that market conditions change and in the end, you don't know how much you'll get for your present home.

One other option if your home doesn't sell by the time you close is to rent it while holding out for the best offer. But this opens up a new set of problems because it is usually more difficult to sell a home occupied by tenants.

If you are comfortable and can qualify for the "three mortgage" scenario, you might want to consider making an offer that is not contingent upon the sale of your present home. You could ask for a delayed closing to give you more time or you could possibly close and have the owners rent back for a period of time until you sell your home and can take possession.

The less stressful scenario calls for selling your home first. It's easy to understand why: you know just how much you can spend on a new home; you avoid carrying three mortgages; and you won't require a home-sale contingency, which may make negotiations easier.

The new owners of your home may agree to a long closing or a rent-back option so you can take your time, look around, and buy the house that's just right for you.

It's worth noting a few disadvantages to selling your home first. You may feel great pressure to find something fast and even settle for a less-than-ideal home.

You may require interim housing, which could be very stressful if you have to stay with family or friends for an extended period.

Should you decide to rent, it may be difficult to find suitable housing, especially if you have pets. In either case, furniture would have to be moved twice and possibly stored long-term.

Selling first may also involve shuttling children to so that they can attend school in the correct district.

Buy first or sell first? How can you choose between the options?

First, assess your financial condition. Is it healthy enough to withstand a buy-first scenario? How well do you handle stress? Do you have the resources to manage three mortgages and the added responsibility, as a landlord, that comes with renters?

If you sell first, what interim accommodations are available, what do they cost, can you adjust and would they be practical for the long-term?

These are all things you'll need to consider. But you don't have to do it alone. A real estate professional deals with these situations in most transactions and is experienced in the negotiations required to ensure a smooth transition.

Pam and Dave Pettigrew, CRS, are available to answer your questions about real estate. Write to them at Prudential Prime Properties, 3665 JFK Parkway, Fort Collins, CO 80525; call them at 282-9305; e-mail them at FCRealtor@uswest.net or visit their Web site at www.FortCollinsRelocation.com.
LOAD-DATE: November 5, 2002

Evidentiary Exhibit Number 99

Chicago Tribune

May 5, 2000 Friday, CHICAGO SPORTS FINAL EDITION

SECTION: YOUR PLACE; Pg. 14; ZONE: C

LENGTH: 696 words

HEADLINE: CODE WORD;

HOW TO DECIPHER THE MEANING OF 'PRINCIPAL RESIDENCE'

BYLINE: By Robert Bruss, Tribune Media Services.

BODY:

Q--That new $250,000 home-sale tax exemption has me confused. My wife and I spend six or seven months a year living in our Florida home. We spend the remaining five or six months each year in our other residence, which we have owned 23 years. Now we have decided to sell it and live year-round in Florida.

When I phoned the IRS recently about using that $250,000 per owner tax exemption on the sale of our non-Florida home, the agent said it won't qualify since we now spend most of our time in Florida.

I checked the IRS publications, and they refer to a "main home" as qualifying for the $250,000 per owner exemption. It says the seller must have owned and occupied the residence an "aggregate" of two years out of the five years before its sale. I think we qualify, don't you?

A--Yes. Internal Revenue Code 121 was enacted in 1997. Since then, there have been no U.S. Tax Court decisions interpreting it, nor has the IRS issued any regulations. All we have is the statute itself.

Although IRS publications use the term "main home," those words are not found in IRC 121. It uses the term "principal residence" and requires the qualifying sellers to have owned and occupied that residence an "aggregate" of two years in the last five years before its sale. You and your wife clearly qualify, especially considering your long-term ownership.

If your sale profit on the house you and your wife owned 23 years is less than $500,000, you won't even have to report it on your income tax returns.

In what I consider a stupid move, the IRS eliminated IRS form 2119 for reporting the sale of a personal residence. The only principal residence sales that now must be reported on your tax returns are those with sale profits exceeding $250,000 per qualified seller.

For further details, please consult your tax adviser.

Q--I own a seasonal rental cabin in New York state, which is now fully depreciated on my income tax returns. In 2000, I will convert it to personal family use, with no rental income, so I no longer must file Schedule E. Right?

What happens, tax-wise, if 5 or 10 years from now, I decide to sell? My three-month seasonal occupancy will not permit me to use that $250,000 principal residence tax exemption. What should I do then?

A--If you rent that cabin fewer than 14 days per year, you need not report any rental income received nor do you have to file Schedule E with your federal income tax returns.

Since you only occupy that seasonal cabin about three months each year, you will not be able to claim the $250,000 tax exemption when you sell since it is clearly not your principal residence. Unless you greatly

increase your occupancy, you cannot meet the two-out-of-last-five-years occupancy and ownership test. You'll just have to pay the capital gain tax on your sale profit at that time. For further details, please consult your tax adviser.

Q--My husband and I are in the process of buying a home. Our excellent buyer's agent gave us a blank copy of the purchase form her company recommends. She answered 99 percent of our questions; however, when it came to the arbitration clause, she recommended we initial it. Neither my husband nor I felt comfortable with that. Do you recommend home buyers and sellers agree to arbitrate possible disputes?

A--No. I do not think you should give up, in advance, your legal rights to a jury trial, to appeal if the arbitrator is wrong, discovery rights, and evidence rules if a dispute should arise.

Unfortunately, without fully understanding the possible adverse legal consequences, some real estate agents recommend their clients sign the arbitration clauses in purchase agreements.

My suggestion is don't agree in advance to arbitrate home-purchase disputes that might arise later. If a lawsuit later develops, you and the other party can always agree then to arbitrate the dispute, or you can preserve all your legal rights and go to trial.

Have a question about real estate? You can write to Robert Bruss in care of Tribune Real Estate Features Service, 435 N. Michigan Ave., Suite 1400, Chicago, IL 60611. Answers will be provided only through the column.

Owning.

LOAD-DATE: May 5, 2000

Evidentiary Exhibit Number 100

The San Diego Union-Tribune

April 23, 2000, Sunday

SECTION: REAL ESTATE;Pg. H-7

LENGTH: 909 words

HEADLINE: Renting temporarily has its advantages

BYLINE: ROBERT J. BRUSS; Robert J. Bruss is a San Francisco lawyer, broker and nationally syndicated real estate writer. | (C) Tribune Media Services

BODY:

Q: My husband and I will be relocating for about three years. We are trying to decide if we should sell our current home or lease it while we're gone. To compete with other rentals, the rent we can charge will only cover our mortgage payment, property taxes, homeowner's association fees and insurance.

Would renting our home be a smart financial move since, if we sell today, we won't have any taxable profit, due to the $250,000 home-sale exemption?

What tax breaks can we take as investment property owners? If we rent, where can we get standard lease applications and forms?

A: The question to ask yourselves is whether your current home will be worth more in three years. Since your letter comes from a highly desirable area, the only direction your home value will probably go is up during the next three years.

Another question to ask is if you sell your home today and take your tax-free profit, will you be able to buy back into the same housing market in three years? I think you know the answer is no.

Normally, I do not recommend long-distance rentals; however, since you plan to return to the same area in three years, I strongly suggest you do not sell today. Renting for three years, even if you only break even, could be an excellent decision.

While renting you can deduct mortgage interest, property taxes, insurance, homeowner association dues, maintenance and other out-of-pocket expenses from the rent received.

In addition, you can deduct depreciation. That is a noncash tax deduction for estimated wear, tear and obsolescence.

The net result should be a tax loss, thanks to the depreciation deduction. If you have adjusted gross income of less than $100,000, you can deduct up to $25,000 per year of so-called "passive activity" losses from your rental property against your taxable ordinary income.

The result should be tax savings, thanks to your rental property, which is probably appreciating in market value. For further details, please consult your tax adviser.

Carrybacks

Q: About two years ago, we sold our home and carried back a $26,000 second mortgage for our buyers. They usually make their payments on time, but now they are two months behind.

Every month I receive several postcards or letters from individuals and loan firms offering to buy our second mortgage. I replied to one firm but was offered much less than the balance of my mortgage. Since I

really don't enjoy hounding our borrowers for their mortgage payments, should I sell to one of these "loan sharks" at a discount?

A: I understand your situation because I also hold carryback mortgages and receive many letters from discount mortgage buyers. I throw those communications in the trash because I'm not willing to accept the big discounts.

Buying existing mortgages at discounts is a profitable, big business. Discount mortgage buyers, however, provide a valuable service by making your mortgage liquid if you should need to sell it to raise cash.

Frankly, I enjoy managing my mortgages. Most of my monthly payments come in on time; however, my few "deadbeats" give me a challenge to collect from them, knowing my ultimate last-resort weapon is to foreclose.

Unless you need the cash from selling your mortgage at a discount, I suggest you avoid doing so.

Just the fax?

Q: I am a real estate agent who relies on fax and Internet communications to sell houses. However, I am always wary of sending fax copies and getting back fax signatures. So far, I haven't used the Internet for actual listings or sales contracts, but I have several European buyers and sellers who communicate with me via e-mail.

If a dispute should arise, are these faxes and e-mail communications legal in court?

A: Most states have enacted, or are considering, statutes authorizing fax and Internet contract signatures. However, it is still best to follow up such communications with "hard copy" documentation for your clients to sign and send back to you via Federal Express or other overnight courier service.

If you and your client were to appear in court with only fax or e-mail communications as proof, proving your case might be difficult if the other party contests the communication.

If a document is to be recorded, such as a deed, it must be signed and notarized since fax and e-mail is not yet acceptable for recordings.

Conflicted

Q: As a prospective home buyer, I greatly enjoyed your recent advice to hire a "buyer's agent." Recently, I contacted such an agent who advertises that she represents buyers only.

When I asked if I will have to pay her sales commission, she said, "Oh, no. The home seller pays my commission." Isn't that a conflict of interest if the home seller is paying my buyer's agent fee?

A: No. The real estate agency laws of every state specify it doesn't matter who pays the sales commission. That fact does not determine which real estate agent represents whom.

Most buyers' agents are paid their sales commission by the seller. Either the listing agents split their sales commissions with the selling agents, usually 50-50, or a "for sale by owner" seller pays the buyer's agent half of the customary local sales commission. Either way, the buyer does not have to pay the sales commission.

Send general real estate questions to him in care of: The San Diego Union-Tribune, P.O. Box 120191, San Diego 92112-0191. He cannot handle individual requests for assistance.

LOAD-DATE: April 24, 2000

Evidentiary Exhibit Number 101

Times-Picayune (New Orleans, LA)

April 8, 2000 Saturday, ORLEANS

SECTION: REAL ESTATE; Pg. R3

LENGTH: 749 words

HEADLINE: $5,000 MAY WARM COLD-FEET;

DEPOSIT MAY LURE BACK RELUCTANT HOME BUYERS

BYLINE: By David W. Myers

BODY:

Buyers often get scared after signing a purchase agreement, but sellers can use the deposit to warm their "cold feet."

Dear Mr. Myers: We signed a contract to sell our home to a nice young couple. A few days before the sale was supposed to close, the buyers got cold feet and decided to cancel. Now they want their $5,000 deposit back, but we don't think we have to give it to them because we did everything the contract calls for. We're in a tough spot. What should we do now?

Answer: You probably do not need to return the buyers' deposit, as long as you are sure that you have done everything that the sales agreement requires. Refusing to give them their money back might even pressure them into completing the purchase.

The buyers might threaten to sue for the return of their deposit, but it is doubtful that a judge would order you to give it back. You have upheld your end of the contract, but the buyers have not upheld theirs. You could even consider suing the buyers and asking a judge to force them to complete the transaction, although hiring an attorney to present your case would likely cost at least a few thousand dollars and hours of your time.

If I were you, I would keep the buyers' deposit and seriously consider putting the house back on the market. That "tough spot" you think you're in now is really the driver's seat.

*** Trailer value rolling downhill ***

Dear Mr. Myers: I am thinking of buying a trailer home because condos and houses in my area are too expensive. Do trailer homes increase in value as quickly as conventional homes do?

Answer: Trailer homes usually do not go up in value at all. Their prices tend to drop each year (much like a car) because they deteriorate much faster than conventionally built homes. Buying a trailer home only makes sense if the cost of the trailer, combined with the cost of renting a spot for it in a nice trailer park, is cheaper than renting a comparable apartment in the same area.

Rather than buying a trailer, focus on saving more money so you can eventually make a down payment on a house or condo.

Many lenders offer loan programs that require as little as 3 percent down, and some operate programs that can put you into a conventional home for even less. If you already have enough cash to buy a trailer home, you only need to save a little more to make a down payment on a condo or house instead.

*** Rent and taxes ***

Dear Mr. Myers: I read somewhere that a homeowner who decides to rent his home to a tenant automatically loses his right to later sell the property and keep up to

$250,000 of his profits tax-free. Please, Dave, tell me it ain't so!

Answer: OK, it ain't so. As any longtime reader of this column knows, there is nothing "automatic" when it comes to the nation's tax codes.

Current tax law allows single tax filers to keep up to $250,000 and joint filers to keep $500,000 of their home-sale profit tax-free, provided that they have owned and lived in their home for two of the past five years. This means an owner could rent his or her home out for up to three years and still be eligible for the money-saving tax break -- as long as the owner personally occupied the house for the two years before it was rented out.

The only way most homeowners can lose their eligibility is to rent their home out for more than three years. Though the writer of the story you read was incorrect when he said that a homeowner "automatically" loses the tax break by moving out and renting to a tenant, consult a tax professional for details about your personal financial situation.

*** Pricing the Joneses ***

Dear Mr. Myers: How can I find out how much homes in my neighborhood have sold for?

Answer: A real estate agent is always the best source of information about local sales. Many agents will provide a detailed list of recent sales for free, especially if they think it might encourage you to hire them eventually to sell your own home or prompt you to refer them to a potential client.

A few Web sites also provide recent sales data for free, although no single site claims to track every sale in every market. My favorite site for checking home-sale information is operated by a company called Home Price Check (www.homepricecheck.com), which claims to have data on about 70 percent of all resale transactions and covers all 50 of the nation's largest metropolitan areas.

* * * * * * *

Send questions to David Myers/FI FTY, P.O. Box 2960, Culver City, Cal. 90231-2960.

COLUMN: MAILBAG

LOAD-DATE: April 8, 2000

Evidentiary Exhibit Number 102

Orlando Sentinel (Florida)
March 19, 2000 Sunday, METRO

SECTION: HOMES; Pg. J14
LENGTH: 846 words

HEADLINE: INCOME TAX MAY BE DUE ON DEPRECIATED PROPERTY
BYLINE: Robert Bruss
BODY:

QUESTION: We recently sold rental property that we have depreciated for our 16 years of ownership. Will we owe income tax even though it was sold for less than our initial purchase price?

ANSWER: Probably. If you sold for more than the property's depreciated book value, called adjusted cost basis, you will owe capital gains tax.

For example, suppose you paid $100,000 for the property and depreciated it by $1,000 for each of 16 years. That brings your adjusted cost basis down to $84,000. Suppose you sold the property for $90,000. Although that is less than your $100,000 purchase price, it is $6,000 above your depreciated adjusted cost basis, so the $6,000 capital gain is taxable at a 20 percent federal tax rate.

SELLER RENT-BACK

Q: I am in the process of buying my first home, and the sale is to close at the end of January. Now the seller wants to rent the house back from me for a month. Her new house won't be finished until late February. Do I have to rent back to her?

A: No. If your purchase contract does not provide for a rent-back to the seller, you are obligated to abide by only the written terms in that agreement. As a general rule, it isn't smart to rent back to sellers. The primary reason is such sellers often stay beyond the agreed time.

However, if you do rent back to the seller, be sure to have a written rental contract and hold back the equivalent of two or three months' rent in case the seller doesn't move out when agreed. Consult your insurance agent to be sure you have adequate insurance for such a temporary rental. Also, consult your attorney as to the legal aspects.

CONDO SALE

Q: About 12 years ago, my parents persuaded me to buy a condo, which I did. In the past year, my job was transferred, and it is too far to drive to work. I moved out of the condo, and it is empty and being painted. Before I moved out, I had the condo listed for sale with a reputable real estate agent for eight months to no avail. I believed the asking price was too high, and after five months, the agent would reduce the asking price by only $2,000. I wanted it reduced much more, but the agent wouldn't listen.

I intend to put the condo on the market again soon. Before doing so, I will interview several agents and choose the one that listens to me on the asking price.

Can I make a deal with the agent to provide a higher than normal commission if the agent lists it at my lower price? If I cannot sell, I could try renting, but then I would need to hire a management company. If I

cannot sell and cannot rent, what other options do I have? If I fail to pay the property taxes, can I get the county to sell it for back taxes?

A: I am shocked that your agent failed to follow your instructions. Of course, your first mistake was signing that eight-month listing, which was too long. If you read this column regularly, you know a 90-day listing is recommended. Sign a longer listing only if it has an unconditional cancellation clause in case your agent does a bad job.

Be sure to interview at least three successful local realty agents who have recently sold condos like yours. Each agent should prepare a written comparative market analysis showing recent sales prices of comparable, nearby condos, asking prices of similar condos, asking prices of recently expired neighborhood condos and the agent's recommended asking price.

Then, compare the three CMAs for accuracy and list your home for sale with the best agent at the price you want. Rather than offer a higher than normal sales commission, offer a sales bonus, such as $1,000, to the selling agent who brings you an acceptable purchase offer.

Because you didn't mention a mortgage, I'll presume you have none. As for not paying the property taxes or the monthly condo assessment fees, that is not a smart idea. You could then lose your condo equity either by foreclosure of the condo lien or for unpaid property taxes. The default also can harm your credit report.

If you can't sell or rent the condo, try a lease-option. With a big enough rent credit toward the purchase price, at least 33 percent or perhaps even 50 percent of the rent paid, chances are excellent the lease-option tenant will exercise his purchase option.

LIVING TRUST

Q: I am a widow living with my two daughters. I own my home free and clear. I know I shouldn't put the house in their names because one might meet a man and he could boot me out. But what about putting the title in joint tenancy with right of survivorship. Would this be a good way to avoid probate?

A: The best solution to avoid probate costs and delays is to create a living trust. You will be the initial trustee and beneficiary. If you decide to sell or to refinance, you can still do so. However, if you become incompetent and unable to manage your affairs, then your alternate or successor trustee manages your finances until you die.

The living trust also specifies what happens to your house and other major assets when you pass on. Living trusts are far better than joint tenancy because of the added flexibility.

COLUMN: REAL ESTATE MAILBAG

LOAD-DATE: March 19, 2000

Evidentiary Exhibit Number 103

Ethnic NewsWatch
Wind River News
March 9, 2000

SECTION: Vol. 23; No. 10; Pg. 2
SLI-ACC-NO: 0500WRSB 045 000024
LENGTH: 925 words

HEADLINE: Riverton housing market strong: some softening seen
BODY:
Riverton housing market strong: some softening seen

The residential housing market in Riverton remains strong, three local real estate agents say, although the market in some price ranges in experiencing a bit of softening.

Likewise, the commercial sales market is fairly strong, although not a particularly big part of the market in the county, they say.

1999 was a good sales year for the Riverton real estate market, Mike McDonald of Wind River Realty said.

"As far as total sales go, they were up for the industry," he said.

The market for both sellers and buyers is good right now, said George Piplica of Century 21 Minter, Realtors.

Piplica had a great sales year last year, and the Century 21 office had a good year, he said.

Gary Underwood of Remax All-Star Realtors said sales in 1999 were similar to 1998 for his agency.

Overall we are very optimistic for the future," Underwood said.

McDonald anticipates that the "bargains" in residential sales in Riverton this year will come in high-end homes.

There are a lot of houses in the 120,000 to 200,000 price range, he said, which will have an end result of lowering prices.

Although there aren't a lot of houses priced at more than 200,000 in Riverton, those have been selling well recently, McDonald said.

Piplica agreed that the market for houses priced under 100,000 is very strong.

Like McDonald, he notices a surplus of houses for sale in the 100,000 to 140,000 range. Piplica believes that is because of the wages earned in Riverton. Only so many people can afford to purchase houses in that price range, he said.

Bargains also exist in the market for homes priced less than 80,000, he said.

If more houses in the 40,000 to 50,000 price range were listed, they'd sell, McDonald predicts.

The number of working farms for sale is in short supply, McDonald said. "I could sell a couple of farms if I could find them."

Rural sites for manufactured houses also seem to be in short supply now, McDonald said, although there are lots suitable for those homes within the city limits.

Overall, McDonald thinks there are enough residential properties on the market to satisfy people in Riverton.

Underwood hasn't noticed any real shortages in any parts of the market.

Currently, he estimated there are between 100 to 120 houses listed for sales in Riverton and "a continued supply of good buyers" looking at those houses.

Piplica has observed "small commercial growth" in Riverton. "The warehouses are full. You can't find one that's empty in Riverton," he said.

In some cases, those properties have been filled by small commercial businesses which have started up or come back to town, he said. And those start-ups sometimes mean employees are moving to Riverton, looking to buy residential property, Piplica said.

Like Piplica, Underwood has noticed there are no longer empty warehouses in Riverton.

It seems everyone looking for commercial property wants a 10,000-square foot building, he said. While those aren't available to rent or sell, there is land to build such properties on, he said.

Interest rates have increased recently, and that has affected the market, McDonald said.

The higher rates are keeping some people from buying a house, affecting the sales rate of lower-priced houses.

Underwood pointed out that some people have stopped plans to buy houses because of those recent hikes in the interest rate, assuming that rates will drop again.

"But we think rates are going to continue to increase, so people shouldn't wait," he said. "There is no more uncertainty - Alan Greenspan and everyone says they are going to raise interest rates."

The mix of people buying homes in Riverton remains similar to what it has traditionally been, McDonald said.

As usual, younger people are often upgrading to bigger or more expensive houses; often older people are downsizing to smaller houses. He estimated one-third of his agency's customers are retirees - many are people who grew up around Riverton and wanted to come back after living and working elsewhere for much of their lives.

Others pass through the region or come to Wyoming to hunt and decide to move here after retiring.

Underwood sees a continued demand to buy here from people in Colorado's Front Range. Those people moved to a town with a population of 10,000 or so, he said, and that town has grown to 100,000 or bigger.

"They want to live in a smaller town," he said, and many are looking to Fremont County.

The rental market in the city is about "average," McDonald said, although he knows some people disagree with that perception.

As an example, he pointed out that managers of the Owl Creek Apartments are looking for tenants.

There may not be a lot of houses for rent, he said, but there seem to be enough apartments and mobile homes for rent.

McDonald said rent prices are remaining static.

Piplica termed the rental market in Riverton "soft."

"That's why Realtors are so concerned about the College Hill Development," he said. Fewer people will buy houses if they can rent a new apartment for a low price, he said.

Construction activity in Riverton should pick up quite a bit this year, McDonald said, with work planned at the elementary schools, construction of the new middle school, remodeling for the planned detoxification center and the building of two new banks.

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Leslie Fishbein, president of Kacey Fine Furniture in Denver, Colorado, was not pleased with the recent city council approval of a new basketball stadium in the area bordering her flagship store. In 1992, when she had renewed the lease for the seven-story brick building in Denver's lower downtown (LoDo), she had been confident that this location put her company in a prime position to take advantage of the redevelopment planned for the neighborhood.

By 1995, though, events had changed her outlook. During a quarterly meeting with her employees, Leslie spoke candidly about the problems and challenges that lay before them:

We're at a major decision point for our company. We need to decide where we want to be and what we want to look like. We have six more years on the downtown store lease. Can we keep our energy high and make these six years pay off? Or will we faint and die on the vine? If we can keep the momentum up, we can look at these six years as planning years. But we have to share the same vision and work to achieve the same goals. We have a shared responsibility here. One hundred sixty families depend on you. If we work together, we can accomplish anything. But we can only succeed if we all play the game.

Conditions had not improved by the spring of 1996, and Kacey Fine Furniture faced six more years on an inflexible lease. Leslie was unsure how to keep her employees motivated, knowing that sales levels (and therefore their sales commissions and bonuses) would be increasingly difficult to maintain. Her plans for the company's growth were being threatened as she was diverted to a plan for its survival. Leslie lamented:

Our downtown store is our biggest concern right now. We are the front yard of the largest entertainment complex in a five-state area. Selling furniture is harder than it used to be, especially because downtown is no longer the furniture district that it used to be. When sales decline, employees become non-motivated and are reluctant to initiate changes or take on new responsibilities. We need to keep the energy level high and make sure that all our employees share the same vision so that we're all contributing to the same goals.

THE DENVER FURNITURE MARKET

There were over 250 retail furniture stores in the greater Denver metropolitan area in 1995 serving a population of about two million people. Also in competition with Kacey were the more than 50 establishments that sold used furniture, as well as the many stores that competed in specialty or accessory goods, such as electronics, carpet & floor coverings, artwork and knickknacks. The ten largest furniture retailers in the Denver metropolitan area are listed in Exhibit 1.

Denver, described by Tom Edmonds of Furniture/Today as a "boom-or-bust town" (Edmonds, 1995a) was the fastest-growing furniture market in the U.S. in 1993, and new housing starts promised continued increases over the next several years. In 1993, the six-county Denver metropolitan area furniture sales hit $ 514 million, with the top four independent furniture retailers commanding 74% or about $ 380 million (Edmonds, 1995a). In 1994, Denver area furniture sales reached $ 639 million, a 27.3% increase over 1993 (Conklin, 1995b). Pre-tax profit margins for full-service retailers typically hovered below 4.5%, as companies increasingly competed on price. Edmonds remarked, "The action here is fast and furious to the point that abandoned service stations are finding second lives as sleep shops and futon stores" (Edmonds, 1995a). Contributing to Denver's growth was a population boom fueled by the construction of a new airport and a new baseball stadium. However, most of the population growth was in the outlying suburban areas, as far as 20 miles away from downtown through increasingly heavy traffic. While economists predicted a slowdown, Rick Pederson, of real estate development firm Frederick Ross, had expected Denver's furniture market to remain strong. "1995 is still going to be a very good year. There's a good deal of furniture to be bought for those homes that were bought and were built in 1994" (Edmonds, 1995b). Despite this optimism, 1995 returns indicated a sooner-than-predicted slowdown in sales.

The Denver furniture market was dominated by four full-line independent merchandisers, three national department store chains, and several gallery showrooms and smaller independents which primarily targeted upscale clientele. Competition was fierce between the four largest stores: American Furniture Warehouse, Weberg Furniture, Homestead House, and Kacey Fine Furniture. Each store carried a broad range of products. Homestead House and Kacey offered name-brand merchandise and positioned themselves toward a middle- to upper-middle quality range, and competed primarily on fashion and service. American and Weberg attracted people who tended to be more price-sensitive and less knowledgeable about quality and durability. In many cases, customer groups overlapped significantly, largely because of the subjectivity of furniture style and quality and partly because of the difficulty in differentiating store merchandise in out-of-store advertising. Inside the stores, the layout, sales staff, and merchandise gave clear s ignals of quality and price range. The department stores, specialty sleep shops, sofa houses, and electronics chains competed in both arenas. All major competitors had multiple store locations, including smaller stores in outlying areas. Kacey was the only major full-line retailer with its main store in the downtown area.

While each furniture retailer believed that it was targeting a particular market niche, there was little visible difference in advertising copy or media. There appeared to be little discernible store or brand loyalty, and most customers shopped around. As competition for consumer dollars increased, specialty and department stores positioned themselves against the low prices of the discounters and touted the service of the showroom and design centers. Corrine Brown, owner of the upscale Roche Bobois franchise in Denver, believed that customer service was the key to success. She explained:

I still make house calls on weekends and evenings. I do a lot of the sales training too. There's always [employee] turnover in this business. If people aren't making money with us they're in the wrong business. This is the easiest hard business in town that I know of. Design is not a factor--being a good [interior] designer has nothing to do with being successful in our store. We can cover for that. But being a people person--understanding the psychology of selling-is so much more important. The sales training, teaching people how to open, to qualify, to expand the sale, to service, to make sure a customer will come back to you instead of someone else. We cover people on salary during training but then they're paid straight commission. We pay the highest commission in the city but they have to work for it. Most of our sales are pretty large. We have a very sophisticated clientele so it takes a pro to close a sale. Even the dollar amount, the more demanding they are, the

more willing they are to trust you. Why do you hire a financial counselor when you have a huge amount of money to invest? You'd never think of doing it on your own. You want expert advice as to what stocks are good. So that's why there's room at the top. That's why the good designers make good money. Because good customers trust that their image will be maintained intact.

Leslie observed:

There are three very big players here in Denver. We're number four. We're the littlest of the big guys. All things being equal, there's a fairly equivalent playing field--not necessarily in terms of customer perception but in terms of reality. What I mean is, a sofa is a sofa. It's a prosthetic device. We have designed it for our health, welfare, safety and comfort but once you get that accomplished the real difference is in customer service. We can't compete head-to-head with the big guys because we're one-fourth their size. So we elected to take a different road.

Our modus operandi is to make sure we're sleek and flexible and can move around them. Now I believe the key to that is people. They believe the key to that is made with bricks and mortar or other resources such as inventory or price or selection and I don't think that. There are a lot of alternative distribution outlets now for our products. A lot of customers don't have the brand or store loyalty that they might have had in the '50s or '60s. So what we're hoping is that we can give a fashion-focused, value-oriented reason for coming in.

Hopefully they'll come in because we have a specific appeal in terms of financial transaction or greater service after the sale. We're one of the only ones that offers a full range of products. We carry everything for your home, including window coverings, floor coverings, electronics, furniture. We're trying to make ourselves into a one-stop shop.

Sam Fishbein, who was responsible for all of Kacey's marketing, believed that Kacey's edge over the larger chains lay in its customer orientation. Kacey tracked buyer purchases by style, color, and price range. All order information, including inventory, purchases, and customer accounts, were tracked and analyzed. Sales people were trained and evaluated on customer satisfaction and service after every sale. Sam Fishbein believed that "everyone's looking for a good deal, but if the service isn't there, the price doesn't matter."

COMPANY HISTORY

Kacey Fine Furniture began as Kacey the Linoleum King in 1950. "I didn't want my name on it," explained founder Jack Barton, "because I didn't want the store to be a reflection of me; I wanted the store to focus on delivering the best products and services to our customers." Jack chose a name that he thought would be easy for people to pronounce and remember. In 1965 he changed the name to reflect his new product line: fine furniture. His wife, Shirley, joined the store in 1966 when the store employed only two sales people and a driver who used his own truck for furniture deliveries. Jack mused: "We were overwhelmed with customers, sometimes 5 or 6 in one day."

Jack and Shirley's oldest daughter, Leslie, started working at Kacey Fine Furniture in 1974 after graduating from the University of Colorado with a degree in Fine Arts. She married Sam Fishbein in December 1976. Sam had recently completed a degree in marketing at the University of Colorado and was working as a building materials salesman. Knowing nothing about the furniture business, Sam eased into the business by helping with Kacey's promotions and advertising. Within five years, Sam's marketing skills and Leslie's managerial and design skills transformed Kacey from a small family business to a major player in Denver's growing furniture market. By 1984, Sam and Leslie were running the show.

Kacey moved into its current location on December 23, 1982, having been given notice in September 1982, to move by the end of that year. The building they had occupied for 15 years was sold quickly because the owner had died. The new owner planned to raze the building to build a more modern structure. Kacey was able to secure a 10-year lease on a seven-story, 65,000-square-foot brick building in lower downtown, only a few blocks away from the previous location. In addition to its larger showroom space, this new location had ample room for parking behind the building. The move was difficult, however, for the employees whose schedules and duties were interrupted and whose sales commissions suffered during the transition. Some employees left, fearing the vulnerability of the company--and their jobs.

The early '80s were expansion years. In 1981, Leslie and Sam opened a small (6,500 square feet) store in the mountain town of Frisco. In 1983, a 30,000-square-foot store was opened in the northwest suburb of Lakewood. Later that year, they leased 126,000 square feet of warehouse space in a former Gates Rubber Company facility. By 1984, sales reached $ 4 million.

Sales grew over the next three years, but the late 1980s brought an economic downturn which made the furniture industry a difficult business. By 1988 Kacey was barely breaking even and morale was low. In 1990 Leslie and Sam sold their house and worked without a paycheck to avoid laying off any of their employees. Leslie and Sam, while role models of hard work, found it increasingly difficult to get their employees to take initiative. Employees were paid on a commission basis, which directed their behavior toward making a sale, with little thought about operational efficiencies, vendor relations, or customer service that might bring in repeat business.

Leslie explained:

In 1987 we were at $ 14 million and in 1989 were at $ 12 million. We went backwards which was not a fun thing to do. We really were frustrated because I wanted people [employees] to take it upon themselves to handle problem situations and satisfy customers without coming to me or a manager for help all the time. I couldn't figure out why they weren't capable or comfortable making decisions. As it was, I was working 10-14-hour days and I didn't want to make all the decisions in my company. I was tired of that.

We're not a high-tech industry. Our concerns center around people as our major resource: we're labor intensive as are most small businesses, especially if you're in the retail business. We're driven by sales and the quality of sales people drives our business to a large degree. As an owner I was very interested in trying to get people to act like owners--to take greater ownership. Because we're a small business, we each wear lots of hats. I wanted people to have greater accountability and responsibility. But they kept coming to me as if I had all the answers.

EMPLOYEE INVOLVEMENT TO THE RESCUE

Leslie discovered a vehicle for increasing her employees' accountability and responsibility in a 1992 seminar run by Jack Stack, CEO of the Springfield Remanufacturing Corporation. Springfield Remanufacturing Corporation had emerged from an employee-buyout of one division of International Harvester's bankruptcy reorganization in 1979. Stack's book, The Great Game of Business (1992) is a managers' guide to profitability through employee involvement and open-book management. Leslie and Sam Fishbein found that Stack's managerial philosophy squared with their own orientation toward employee involvement, and in October, 1992, began its implementation.

The Great Game of Business is a company-wide open-book management system. It's become part of our corporate culture so that everyone shares the same mission and buys into the plan. We teach all of our

employees cash flow analysis, income statement, balance sheet--based on their level of education or understanding. They are involved in decision making at all levels of the organization. We have a gain-sharing program based upon what everybody achieves according to preset profit goals. We paid out $ 750,000 in bonus checks in 1994. All employees received at least 11% in bonuses. The managers got 45% of their salaries as bonuses. It's very lucrative. I believe in the "what's in it for me" aspect.

When we started the Great Game of Business I was worried about certain parts of the company. I went to people in the warehouse and shop who are very important to our business and I said to them, "If you can understand arcane baseball statistics, which make no sense to me, you can understand business." And they looked at me wide-eyed because most people don't get any economics, any information about how a business runs, what impacts it, what expenditures are, how to balance it to make a profit or not. They don't learn that in school. Our education system is totally deficient in this.

We tell our employees, "this is the company you work in, this is what it does, this is how you impact everybody, this is what your decision will do, we're going to let you make that decision but you'll have more information to make it." That opens up a whole new world to somebody. Sometimes they'll come to me [for advice] and I'll say, "you can make as good a decision as I can. I've never done this before either," and it's interesting to see how that works. They often know what they need to do better than I do. Certainly I've made a lot of mistakes and mine are usually pretty costly.

We spend a lot of time, energy and resources teaching our employees things that most people don't have access to. The reason I think this is so critical is because you can stop me but you can't stop 160 people. We are in a fairly competitive environment. Denver is considered one of the most competitive retail furniture environments in the country. We are the littlest of the big guys here and so we look to have a strategic advantage through our people.

Tom O'Donnell, Operations Manager, believed that Kacey's company-wide gain-sharing bonus plan gave delivery drivers

... a chance to keep up with the rest of the world. These people typically live month-to-month and something unexpected--like a car repair--can put them under. Bonuses can add 10% to their base salary and allow them to get ahead.

This system gives them the rules of the game. They see how they can make a difference. Last month we had a bad snow storm. Everyone was here at 6 a.m. We had no delays. No tow bills. We had seven trucks instead of six on Saturday because one of our drivers volunteered for extra duty. We delivered $ 208,000 worth of furniture on Saturday [which was a record for a single day's deliveries].

Mike Bradford, Kacey Chief Financial Officer, was responsible for making sure that every manager's sales and profitability targets were recorded and monitored. At biweekly staff meetings, all financial information was displayed interactively on a computer-driven 60" color television. [See Exhibits 2 and 3 for Kacey Financial performance summaries.]

Leslie explained,

Everybody has certain expense categories that they're responsible for, so if they're over budget they have to stand up in the meeting and explain why. For example, I went over on our cleaning budget because I felt that the stores had to be cleaner than they were, so I authorized increasing our cleaning schedule--we have a contract with an outside cleaning company--without going to the committee. So I had to stand up at a Great Game of Business meeting and say, "this is my rationale for doing this. If you all disagree, I'll cut it back," but everyone

agreed. If anyone is over budget in any area, including wages, then they have to stand up and defend their position. It may be justified, but we don't want expenses to become runaway. We need to understand where they come from. It's easy to see retained earnings. They can see that I haven't taken much out.

All employees understood the cost of repairs and maintenance, display supplies, utilities, promotions, returns, sales tags and light bulbs. Employees took the lead in cost-cutting. Leslie recalled:

One of the managers decided that we weren't dealing with our freight problem very well. Everything has to come in from somewhere and freight is a very significant factor in our company's profit picture. So he went to school and learned everything he could about freight. Now, if you know anything about freight, you know that it's very arcane. But as a result of his ideas we now have one of the lowest incoming freight rates of anybody in the country. We were delighted to reward him for it and participate in that.

The Emerging Company Culture

Kacey Fine Furniture had had a "family focus" since its inception. "Kacey's been in my family since I was a little kid," remarked Leslie. "It was part of our life." In 1995, Kacey was still oriented toward families and community involvement.

Because we're a family corporation we have lots of families who work for our company. We have brother-sister, husband-wife, nieces, nephews, cousins, lots of people who work together. We not only allow nepotism, we promote it. We make sure that one family member does not supervise another family member but they can work side by side. It gives us a chance to have a more coherent team to start with. We make sure everyone knows they stand alone so a brother or cousin or spouse doesn't affect their performance.

Several employees expressed the difference in attitude at Kacey's compared to other stores where they had worked. Brenda, a sales associate who had worked at Kacey for several years, expressed a typical sentiment:

There's a real difference here in how they take an interest in what we have to say. They take our suggestions to heart. They listen to what we have to say and they care about what we say and they're not just thinking of themselves...it's a group effort. We actually get paid for ideas that they put into effect, or just suggestions--we have a place to voice our opinions.

Leslie's interpretation of Stack's Great Game of Business involved more than opening the books to her employees. In preparation for changing employees' behavior, she hired a management consultant and conducted employee satisfaction surveys. She tried to understand why some employees worked well together and why others remained isolated. She examined her own behavior as well, and decided that poor performance was better dealt with through training and coaching than through reprimands and firing. An inspirational motivator herself, she didn't want to be too tough on employees, while at the same time she knew that she needed a better control system that didn't require top-down management authority and control.

Leslie acknowledged:

We're not an easy company to work with or for. Because we're retail we're open 9 to 9. The only time we can have our company-wide meetings is at 7:30 in the morning. We're not a democracy, but we require a great degree of participation, involvement, and continuing education and that's not really easy. We have a lot of meetings at our company and we expect a lot of people to participate at odd times. For example, our quarterly meetings are mandatory for everybody and they also need to participate in one major huddle [department] meeting a month. We don't do company picnics or parties, because we have enough meetings and we believe your private time is your private time and we don't want to impinge upon that. But we do try to find ways to have fun. We do skits and songs at our quarterly meetings and have games where we give out goofy prizes.

Quarterly meetings began to take on a different tone. Some of the early meetings were orchestrated by Leslie and her father. They performed skits, conducted sing-a-longs and role-plays, and gave out prizes for cost-reduction ideas such as delivery routings and scheduling. Revenue-generation ideas such as billboard-type logos on their delivery trucks earned cash bonuses. As employee suggestions and involvement increased, the nature and format of the meetings changed.

Mike Bradford's job changed from compiling information and tracking revenues and expenses to conducting accounting and training seminars. Everyone was required to understand basic accounting principles, and short-courses were designed to accommodate employees' work and family schedules and preferences. A tuition-reimbursement program was instituted so that employees could take courses at nearby universities, in subjects ranging from finance and accounting to graphic design.

By 1995, department managers had created their own awards. A monthly newsletter became a forum for idea exchange and information sharing. Employee birthdays, marriages and anniversaries, births and transitions were celebrated. Illnesses and tragedies brought compassion and assistance. Different people took turns making presentations or announcements at the company-wide gatherings. New employees were introduced, promotions and accomplishments acknowledged, teamwork and departmental productivity publicized. Customer-appreciation letters as well as customer-complaint letters were read and publicized in company newsletters.

Increasingly, managers took on the role of coaches and trainers instead of schedulers and disciplinarians. Employees often formed study groups and shared information and ideas. The lines separating owners and managers and staff and customers became less distinct as titles and job descriptions took a back seat to camaraderie and strategic planning. Each department had control of its own operations, with profit sharing based on store-wide and company-wide profitability. Approval for new ideas or programs was based on cost-revenue projections and employee participation, not management preference. Employees at one store decided to change their hours of operation to allow more evening shopping opportunities. ("Can you imagine me suggesting such a thing?" Leslie remarked.)

I think that education is one of the most critical things we can do as a business. The more education my workforce has and the more involved that they are in understanding issues--even contemporary issues--the more responsible they will be. I think of my employees as citizens and they must relate to the world as a whole. We also have a "great voter turnout" program. Now that may not seem very important to you but it is to me. I don't care who you vote for but I want to make sure they participate. As a consequence of understanding more about business and what they can do to affect their businesses, they've actually had more outreach into the community and I'm absolutely delighted about that. It's something that I kind of predicted but didn't think would happen as quickly as it did.

THE CHANGING LODO NEIGHBORHOOD

The South Platte River, the major waterway between the Rocky Mountains and the Great Plains, divided the western third from the eastern two-thirds of the city of Denver. Until the early 1970s, Denver dominated the six-county metropolitan area. In 1973, 45 acres bordering the west bank of the Platte River were cleared and sold for commercial and industrial redevelopment. In 1976, 169 acres of land east of the Platte River were developed into the Auraria Higher Education Center, which housed Metropolitan State College of Denver, the University of Colorado at Denver, and the Community College of Denver. The national economic downturn, fueled by heavier dependence on foreign oil, took its toll on Denver, creating high unemployment and a

deteriorating downtown area, as the population shifted to outlying suburban areas. By the late 1980s, only one-third of the metropolitan area population remained within the Denver city limits.

In 1986, the 45 acres on the west bank of the Platte River, known as "lower downtown" or LoDo, was a run-down commercial and industrial center adjacent to the largest tract of undeveloped land in the metro area. While much of the land was still owned by the Southern Pacific Railroad, the mayor commissioned a steering committee, composed of "community, business, railroad and property owner representatives from neighborhoods within and adjacent to the Central Platte Valley" (Central Platte Valley Comprehensive Plan Amendment 1991) to develop a comprehensive plan for the area. Following the recommendations of the committee's 1991 comprehensive plan amendment, LoDo underwent urban redevelopment. Art galleries and retail establishments cropped up between the railyards and the warehouses, taking advantage of low rent and ample parking. Following the rehabilitation of some of LoDo's historic buildings, the granting of a major league baseball franchise in 1993, the relocation of Elitch Gardens (a $ 95 million, 67-acr e Amusement Park) to LoDo in 1995, the Gates Foundation pledge in December 1994 of $ 1.2 million toward a $ 64 million public aquarium to begin construction in 1996, "the development of hundreds of units of new housing, the opening of 16 new restaurants and bars [in 1994 and 1995], plans to create a new historic district and revise the area's zoning" (Steers, 1995) and the proposed construction of additional sports and entertainment complexes, the face of LoDo began to change visibly.

On March 31, 1995, the first Colorado Rockies exhibition game was played at Coors Field, one mile north of Kacey's downtown store. The baseball season officially opened on April 26, 1995, to a capacity crowd of 50,200; attendance averaged 45,000 throughout the summer and fall of 1995. The Rockies played in the National League Championship Series in 1995, ensuring their popularity with the home crowd for the 1996 season.

As lease rates increased from $ 8-$ 10 to $ 18-$ 20 per square foot, many art galleries moved away from LoDo and restaurants, brew-pubs and housing units moved in. By 1996 there were 60 restaurants in LoDo--up from 35 in 1993--all sustaining year-round traffic. "One of the things Coors Field has done has been to demystify lower downtown for people who didn't know what it meant," observed Richard Holcomb, executive director of the Lower Downtown District Inc. (Parker, 1996). Townhouses and loft apartments increased from 270 in 1993 to 340 in 1996, with more than 370 new units planned by 1999. The number of LoDo residents was expected to double, from 1,500 to 3,000.

On April 26, 1995, Entertainment Development Group announced an agreement with United Artists Theater Circuit, Inc., to construct an 80,000-square foot theater and entertainment complex on the 16th Street mall, at the southeast edge of LoDo (Rebchook, 1995). The following month, Ascent Entertainment Group (owner of the Denver Nuggets basketball team) acquired a National Hockey League franchise by purchasing the financially distressed Quebec Nordiques, renamed the Colorado Avalanche. The Avalanche's first season success in the Stanley Cup playoffs overlapped the 1996 baseball season with sell-out crowds for both teams' games throughout April and May.

LoDo was changing from a low-rent commercial district to a high-rent entertainment area, with increased activity in the area east of Cherry Creek. The buildings between Auraria Parkway and the railroad tracks, however, that once housed the furniture district, were soon vacant and Kacey's seven-story building was a drive-by landmark, a destination place only for those who went out of their way to stop.

Although the number of housing units increased, furniture sales in LoDo suffered. On April 10, 1995, Franklin Furniture, located two blocks from Coors Field, announced that it planned to move to the suburbs by

spring of 1996. "Business has been getting worse in the last two years because there is no parking," and sales have dropped 20%, owner Jerry Kozatch explained. (Conklin, 1995a). While Franklin Furniture owned its building, it had to buy parking permits for trucks at its loading dock.

Despite public criticism of both the building of a new basketball stadium (the current Nuggets stadium was only 18 years old) and the revenue consequences of public subsidies, the City Council approved a contract for the new stadium. PepsiCo had agreed to pay $ 68 million (of the $ 132 million estimated costs) for its name on the stadium and exclusive advertising and "pouring" rights. After heated negotiations between Phil Anschutz, majority owner of the Southern Pacific Railroad's 43-acre Platte Valley site, and Ascent Entertainment, construction of the "Pepsi Center" stadium was expected to begin by the end of the summer of 1996. Construction was expected to take two years. Leslie explained how the changes affected her store:

The Nuggets [basketball] stadium is going directly behind my store. That is an absolute, unqualified disaster. We are beside ourselves right now because between the baseball and ice hockey here now, this is becoming a sports and entertainment area. Frankly, the consequence for a retail store is that nobody's going to get in or out of here. The city council members don't seem to understand that if you add 20,000 people coming for a Nuggets game to the Auraria Higher Education [college campus] night student traffic, same-time use with Elitch's [amusement park], the Aquarium and the [proposed 12-screen movie] theaters, you could have the potential of anywhere from 50,000 to 75,000 to 150,000 people trying to get into an area. Now the parking spaces that they have for all of us is 44,000, with the Rockies [new baseball stadium] it's 88,000. We're already seeing a decline in customer traffic during Rockies games. Now they want to move the Nuggets closer to us also. (sarcastically) I can hardly wait.

WEATHERING THE STORM: BRACING FOR A DOWNTURN IN 1996

Both the extent of the changes in LoDo and the evolving nature of those changes troubled Leslie when she contemplated the future of her downtown store. What had once seemed promising now appeared threatening to Kacey. Leslie explained:

The original plan for the Platte Valley included mixed use, which was retail, residential and commercial. That would have been a whole different idea. People who come downtown for sports events are not the people who come downtown to buy furniture. We looked at our lease to try to figure out if we could get out of the situation that we're going to be in, but the owner won't budge. With all the changes taking place in this area, I think there are better uses for this building than us, but it doesn't appear that the principal agrees with us. He has refused to let us sublet the building or buy it from him. If customers can't get here, our sales people may have to be more adept at housecalls and getting into the customer's home and taking things to them versus having the customer come to us. And that's not entirely unfeasible. It's possible, but that would require a lot of training and orientation.

Not everyone believed that the downtown location was a liability. Operations Manager Tom O'Donnell believed that "as we become more of a dominant regional player, the visibility of our downtown store will be more of an asset." He explained:

Each of our stores is different, yet the downtown focal point draws customers from all of our outlying stores. We may need to reorient our sales staff and change our service options, but this might not be a bad thing. There's lots of money to be made on in-home sales and that market is wide open. There's a lot of potential for creativity. We could drop down to four--even three--floors at this location and still keep our image while we're in the process of relocating to a better location. We have six more years on this lease, but even if we started

today, it would take us at least two years to get a big, full-size formal showroom up and running in another location.

We're not the upper-end designer market, nor are we the lower-end American or Weberg market. Our most serious competition in this area is probably Ethan Allen. Our market niche is an educated, serious furniture buyer. You're talking about a consumer who's going to spend $ 10,000-$ 20,000 on a dining room or bedroom suite, or get into a specific design group and over a period of three or four years spend maybe $ 25,000. That's a major lifetime commitment. When you're going to spend $ 25,000, you'll spend the day and go where you can get the best price. We can't build seven or eight complete stores. Nor is it necessary. You'd end up with seven or eight times the amount of shop-worn furniture in the process anyway. But we need one key dominant store where we can refer people to, where an entire group can be shown. And that's the kind of store we have downtown today. Is it the right building, the right facility? It really doesn't matter if it's a different building, different numbers of floors, a little smaller, a li ttle larger. It allows us to have a central theme and I think that's important. To be a leader in this market, we need to have a dominant regional presence. I think a flagship store is a good idea, but only if we can offer the personalized service people want.

Leslie was sure that accessible, attractive showrooms were essential. People needed to see and touch furniture before they would buy it. Bringing fabric samples to someone's home would not be enough. Whether or not they moved away from downtown, the next six years would place a strain on all Kacey employees. Leslie believed that employee confidence and sustained profitability would be essential for the company to position itself for a big move.

Even if we decide to move away from downtown eventually, we need to stay put and deal with what we have now. The suburban area rents are priced at the top of the market right now. Denver is a competitive market; our margins are low. If we can hang on until the shakeout, we'll have some options.

Leslie knew that the human resources systems that she had worked so hard to establish would be severely tested. She hoped that the Great Game of Business would be enough to maintain the commitment and enthusiasm that would be needed to keep the downtown store profitable until feasible relocation options could be explored. But already, the spring 1996 sales figures did not look promising. If sales continued to dip below projections, employees would not get fiscal-year-end bonus checks in June. Would her "Great Game" strike out? Leslie was not sure how to rally her employees for the challenging times that lay ahead.

Joan Winn is Associate Professor of Management at the University of Denver.

This case was prepared by Professor Joan Winn of the University of Denver as the basis for class discussion rather than to illustrate the effective or ineffective handling of a managerial situation. All events and individuals in this case are real, but same names may have been disguised.

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Top Denver Area Full-Service Furniture Stores

The Largest Furniture Retailers in the

Denver Metropolitan Area 1993-94

Sales 1994 Sales [*] Number

($ millions) [*] Metro Denver of

1993/1994 Only Stores

American Furniture

Warehouse $ 85.0/$ 104.0 $ 94.0 4/8

Weberg Enterprise $ 132.1/$ 138.5 $ 60.0 4/32

Homestead House $ 101.0/$ 119.0 $ 22.0 4/21

Kacey Fine Furniture $ 24.0/$ 28.0 $ 26.5 3/4

Montgomery Ward [**] $ 770.0/NA 7/347

Levitz [**] $ 985.6/$ 1036.3 3/135

Ethan Allen [**] $ 87.0/$ 123.5 3/54 [2]

La-Z-Boy Furniture

Gallery [**] $ 372.4/$ 412.2 4/263

Sears HomeLife [**] $ 900.0/$ 600.0 2/NA

Thomasville [**] $ 202.1/$ 228.0 2/86

Foley's Home Store [**] $ 52.0/$ 53.0 1/40

INDUSTRY TOTAL $ 42,500/$ 45,300 $ 639

Sq Sales

Feet per

(000) sq Foot Employees

American Furniture

Warehouse 412 $ 253 350

Weberg Enterprise 980 $ 150

Homestead House 190 425

Kacey Fine Furniture 115 $ 233 160

Montgomery Ward [**]

Levitz [**] 6,570 $ 165 6500

Ethan Allen [**] 5880

La-Z-Boy Furniture

Gallery [**] 42 average $ 171

Sears HomeLife [**] 12

Thomasville [**] 120 8000

Foley's Home Store [**] 6

INDUSTRY TOTAL $ 120

(1.)Denver metropolitan area/Total US.

(2.)Company owned stores only; there are also 233 dealer-owned stores.

(*.)Sales in millions. Figures are for calendar year or most current fiscal year.

(**.)National chains; sales totals reflect nation-wide operations.

Source: Furniture Today, May 23, 1994, March 6, 1995, May 29, 1995, July 31, 1995, August 21, 1995.

Kacey Income Statements

Year Ending May 31 1995 1994 1993

Revenues

SO1: Downtown $ 15,033,979 $ 12,320,080 $ 10,020,263

SO2: Frisco $ 1,732,679 $ 1,468,804 $ 1,367,449

S03: Lakewood $ 9,076,013 $ 7,947,617 $ 6,930,604

$ 06: Clearance Center $ 1,613,965 $ 1,015,733 $ 859,796

Total store sales $ 27,456,636 $ 22,752,234 $ 19,178,112

Sales to employees $ 136,056 $ 81,345 $ 29,757

Gross sales $ 27,592,692 $ 22,833,579 $ 19,207,869

Cost of Goods Sold

S01: Downtown $ 8,290,229 $ 6,596,012 $ 5,304,338

S02: Frisco $ 930,948 $ 781,933 $ 735,892

S03: Lakewood $ 4,991,667 $ 4,268,936 $ 3,670,655

S06: Clearance Center $ 1,106,015 $ 829,448 $ 645,986

Total CGS $ 15,318,859 $ 12,476,329 $ 10,356,871

Operating Expenses

GSA $ 3,584,175 $ 2,770,602 $ 2,932,294

Advertising/promotions $ 2,017,409 $ 1,787,992 $ 1,736,428

Misc delivery/handling $ 1,332,509 $ 1,168,338 $ 871,999

Operating Expenses

SO1: Downtown $ 1,935,630 $ 1,646,453 $ 1,535,856

S02: Frisco $ 383,060 $ 351,600 $ 312,963

$ 03: Lakewood $ 1,153,459 $ 1,054,519 $ 884,150

$ 06: Clearance Center $ 440,267 $ 220,057 $ 208,291

Total Operating Expenses $ 10,846,509 $ 8,999,561 $ 8,481,981

Other (vendor fees) ($ 37,292) ($ 54,838) ($ 19,487)

Net Profit before bonus/tax $ 1,464,616 $ 1,412,527 $ 388,504

Bonus paid $ 853,035 $ 709,658

Net Profit before taxes $ 611,581 $ 702,869 $ 388,504

Taxes $ 224,544 $ 258,115 $ 151,283

Net Profit $ 387,037 $ 444,754 $ 237,221

Year Ending May 31 1992 1991

Revenues

SO1: Downtown $ 9,482,092 $ 7,753,878

SO2: Frisco $ 1,079,747 $ 1,004,290

S03: Lakewood $ 6,143,633 $ 4,236,460

$ 06: Clearance Center $ 753,378 $ 336,130

Total store sales $ 17,458,850 $ 13,330,758

Sales to employees $ 38,761 $ 19,822

Gross sales $ 17,497,611 $ 13,350,580

Cost of Goods Sold

S01: Downtown $ 5,243,989 $ 4,182,463

S02: Frisco $ 603,851 $ 563,568

S03: Lakewood $ 3,407,935 $ 2,405,011

S06: Clearance Center $ 710,304 $ 338,566

Total CGS $ 9,966,079 $ 7,489,608

Operating Expenses

GSA $ 2,252,403 $ 1,836,821

Advertising/promotions $ 2,003,507 $ 1,367,629

Misc delivery/handling $ 730,076 $ 543,265

Operating Expenses

SO1: Downtown $ 1,378,142 $ 1,202,442

S02: Frisco $ 233,868 $ 214,542

$ 03: Lakewood $ 691,905 $ 569,044

$ 06: Clearance Center $ 123,318 $ 105,010

Total Operating Expenses $ 7,413,219 $ 5,838,753

Other (vendor fees) ($ 4,953) $ 41,165

Net Profit before bonus/tax $ 123,266 ($ 18,946)

Bonus paid

Net Profit before taxes $ 123,266 ($ 18,946)

Taxes $ 15,799 $ 5,344

Net Profit $ 107,467 ($ 24,290)

Kacey Balance Sheet

Year Ending May 31 1995 1994

Cash on Hand $ 187,324 $ 707,593

Accounts Receivable $ 260,976 $ 96,321

Inventory at Landed Cost $ 4,074,981 $ 3,559,222

Income Tax Refundable $ 18,409

Prepaid Expenses $ 123,864 $ 42,901

Deposit--Current

Deferred Tax Asset $ 147,431 $ 126,486

Property/Plant/Equipment (PPE) $ 2,245,904 $ 2,156,540

Less: Accumulated Depreciation ($ 1,373,182) ($ 1,379,567)

PP&E Net $ 872,722 $ 776,973

Other $ 269,780 $ 301,628

TOTAL ASSETS $ 5,955,487 $ 5,611,124

Line of Credit $ 0 $ 0

Current Portion/due on account $ 68,516 $ 59,348

Accounts Payable $ 1,128,497 $ 1,254,240

Accrued Liabilities $ 701,471 $ 604,636

Customer Deposits $ 1,798,175 $ 1,648,861

Income Tax Payable $ 110,134

Total Current Liabilities $ 3,696,659 $ 3,677,219

Long-Term Debt $ 228,538 $ 290,652

Equity $ 2,030,290 $ 1,643,253

TOTAL LIABILITIES & EQUITY $ 5,955,487 $ 5,611,124

Year Ending May 31 1993 1992

Cash on Hand $ 122,192 $ 63,231

Accounts Receivable $ 197,556 $ 126,364

Inventory at Landed Cost $ 3,136,816 $ 2,708,124

Income Tax Refundable

Prepaid Expenses $ 40,610 $ 60,613

Deposit--Current

Deferred Tax Asset $ 120,420 $ 94,392

Property/Plant/Equipment (PPE) $ 1,679,323 $ 1,575,045

Less: Accumulated Depreciation ($ 1,240,236) ($ 1,138,400)

PP&E Net $ 439,087 $ 436,645

Other $ 309,291 $ 240,403

TOTAL ASSETS $ 4,365,972 $ 3,729,772

Line of Credit $ 65,000 $ 0

Current Portion/due on account $ 5,982 $ 14,761

Accounts Payable $ 978,993 $ 860,185

Accrued Liabilities $ 459,096 $ 252,388

Customer Deposits $ 1,501,211 $ 1,622,601

Income Tax Payable $ 157,192 $ 12,578

Total Current Liabilities $ 3,167,474 $ 2,762,513

Long-Term Debt $ 5,982

Equity $ 1,198,498 $ 961,277

TOTAL LIABILITIES & EQUITY $ 4,365,972 $ 3,729,772

Year Ending May 31 1991

Cash on Hand $ 416

Accounts Receivable $ 111,810

Inventory at Landed Cost $ 2,723,128

Income Tax Refundable $ 22,064

Prepaid Expenses $ 84,302

Deposit--Current $ 20,500

Deferred Tax Asset $ 90,810

Property/Plant/Equipment (PPE) $ 1,648,284

Less: Accumulated Depreciation ($ 1,223,772)

PP&E Net $ 424,512

Other $ 162,872

TOTAL ASSETS $ 3,640,414

Line of Credit $ 180,000

Current Portion/due on account $ 22,850

Accounts Payable $ 953,219

Accrued Liabilities $ 226,067

Customer Deposits $ 1,382,851

Income Tax Payable

Total Current Liabilities $ 2,764,987

Long-Term Debt $ 21,617

Equity $ 853,810

TOTAL LIABILITIES & EQUITY $ 3,640,414

IAC-CREATE-DATE: May 16, 2001
LOAD-DATE: May 17, 2001

Evidentiary Exhibit Number 105

The Seattle Times

November 20, 1999, Saturday Final Edition

Correction Appended

SECTION: SATURDAY REAL ESTATE; Pg. E1

LENGTH: 857 words

HEADLINE: THE HIGH-RENT DISTRICT -- PLUSH NEW APARTMENTS LURE TENANTS WHO HAPPILY WRITE CHECKS EACH MONTH FOR AS MUCH AS $ 3,500

BYLINE: BILL KOSSEN; SEATTLE TIMES STAFF REPORTER

BODY:

It's not just the BMWs in the parking lot, or names like Le Chateau at Richards Creek or Lochshire on Forbes Creek that tell you this is not your typical apartment complex.

It's not even the parklike landscaping, the balconies with wrought-iron railings, the tile and marble accents, the big windows, wood cabinets, soundproof walls and security systems.

No, when it comes to one of the hottest new-home markets - high-end apartments - it's the price of admission that sets it apart.

At a time when many tenants are cringing at rising rents that average $ 724 a month in the Seattle area, people willing to pay $ 1,500 to $ 3,500 a month are quickly filling new high-end apartments in Kirkland, Bellevue, Seattle and even Renton.

Any stigma attached to living in an apartment is fast falling by the wayside, said Mike Scott of Dupre+Scott Apartment Advisors. The high-end units are attracting people with money who might be between houses, jobs or relationships and want to maintain a nice home.

"People in their 40s and 50s don't consider rental housing a negative," Scott said. "The whole rental market has changed from selling a place to live to selling a concept."

And much of the new construction is high-end apartment buildings, he added. That's a dramatic change from the early 1990s, when the first new-breed upscale apartments were being built in the Seattle area.

High-end apartments were built on Capitol Hill in the 1920s, Scott said, and those Fred Anhalt-built buildings survive today with their grand lobbies and quality craftsmanship. But they were the exception for decades, he said.

When Carillon Heights opened in Kirkland in 1991, it took more than a year to fill its 179 units, for which rents now range from $ 2,000 to $ 3,500 a month, said Walt Smith, a vice president at HSC Real Estate in Seattle, an apartment-management company handling 11,000 units across the state.

The apartment complex overlooking Lake Washington defied the condo-building frenzy at the time.

"It hadn't been tried here. We certainly had some concern," Smith said.

Why are such expensive apartments so popular? Simple, says Smith: "There's more money."

Many developers are diving into the high-end apartment market, which is being fueled by the wealth of the area, a general increase in apartment rents and the ease with which property owners can sell entire buildings, instead of individual condo units.

About 4,000 units that rent for more than $ 1,000 have been built in the past year in the Puget Sound region, primarily the Seattle area, according to Dupre+Scott. At the same time, the number of apartments renting for less than $ 650 has dropped by 13,000.

The trend is occurring across the nation as empty-nesters and others sell their houses and move into attractive, low-maintenance apartments while they decide where to live next, Smith said.

That's the case with Dino and Rosie Serventi, who were among the first to move into Lochshire in Kirkland, just east of Interstate 405. They sold their house in Redmond and are looking for a smaller house to buy.

"We didn't want to rush right into buying something," Dino Serventi said. "We've got time to gather our thoughts."

Serventi said he and his wife, both 52, were just driving around when they came across Lochshire and were struck by its attractive looks and helpful staff.

"We wanted to move up a few notches from a regular apartment," he said, but didn't expect to find much.

After all, he has vivid memories of living in apartments years ago.

"Lots of noise and lots of unkemptness," he said. "Apartments were like crash pads."

That's not the case at Lochshire, where the stylish row-house-like apartments contrast starkly with the small, old homes scattered across Northeast 124th Avenue.

"The whole strip reflects the change that's occurring on the Eastside," said Frank Bosl, a vice president with CB Richard Ellis, a real-estate brokerage company that has been involved in such high-end developments as Lochshire.

Fifteen of the 100 units have been completed and are occupied. The project is scheduled to be done by February, said site manager Shelly Baehler. Monthly rent ranges from $ 1,265 for a 1,000 square-foot, 1-bedroom apartment to $ 2,395 for a 1,600 square-foot, three-bedroom apartment with two-car garage.

It's been a pretty easy sell so far, she said. The rents may seem high to some people around here, but not to people from other parts of the country.

"I love to get the calls from New York and San Francisco. They say, It's a great deal. That's not so much.' "

But despite the homey feel, good service and amenities such as soaking tubs, parking garages, see-through fireplaces and new appliances in each unit, including washer and dryer - these apartments are still apartments and your neighbor today may not be your neighbor tomorrow. Even at the high-end, where six-month leases are common, it's a transient market.

As Baehler put it:

"We don't expect them to stay long."
Bill Kossen's phone message number is 206-464-2331. His e-mail address is: bkossen@seattletimes.com
CORRECTION-DATE: November 21, 1999, Sunday
CORRECTION:
PUBLISHED CORRECTION

THE APARTMENT COMPLEX FEATURED IN THIS STORY IS CALLED LOCHSHIRE ON FORBES LAKE. THE NAME USED IN THE STORY AND PHOTO CAPTIONS WAS PARTIALLY INCORRECT.
GRAPHIC: PHOTO; 1) THOMAS JAMES HURST / THE SEATTLE TIMES: SHELLY BAEHLER, SITE MANAGER AT LOCHSHIRE AT FORBES CREEK, SAYS THE LUXURY APARTMENTS HAVE BEEN AN EASY SELL SO FAR. THE PROJECT IS EXPECTED TO BE COMPLETED IN FEBRUARY. > 2) THOMAS JAMES HURST / THE SEATTLE TIMES: LOCHSHIRE ON FORBES CREEK APARTMENTS IN KIRKLAND ARE PART OF A WAVE OF LUXURY COMPLEXES RECENTLY BUILT IN THE PUGET SOUND AREA. RENTS HERE START AT $ 1,265.
LOAD-DATE: November 25, 1999

Evidentiary Exhibit Number 106

The Cincinnati Enquirer
October 27, 1999 Wednesday All Edition

SECTION: FIN; Pg. 10B
LENGTH: 760 words
HEADLINE: Retirement in "bricks and mortar'
BYLINE: JOHN J. BYCZKOWSKI, The Cincinnati Enquirer
BODY:

Buyers snapping up apartments around Tristate

By JOHN J. BYCZKOWSKI

The Cincinnati Enquirer

Steve Thiemann and his father, Howard, have a plan They're going to buy 100 apartment units this year.

But for a time, they weren't sure they'd make it. "There's more buyers than properties," said Steve, who with his father owns 1,800 units in Greater Cincinnati. "It's tough to find 'em, and they're going for a premium."

With plenty of buyers looking for properties, 1999 is shaping up to be a big year for sales of apartment buildings in Greater Cincinnati. Last year saw just one sale of an apartment complex with more than 200 units.

This year has already seen a half-dozen large sales -- either 200-plus units or more than $5 million -- with several still pending. Those sales so far total more than $50 million.

One of this year's sales set a local record for the highest price paid per unit. Chestnut Hill Square in Hyde Park, with 119 units, sold for $8.6 million, or about $72,630 a unit, by the calculations of Chuck Ciolino of West Shell Commercial Oncor International.

"1997 and 1998 were outstanding years. 1999 seems to be going just as well," said Dave Lockard, a broker for CB Richard Ellis. "It'll be really tough to say (how 1999 compares) in total, because a lot of activity occurs in the fourth quarter."

Jan Alexander of Robinson Realtors agrees. "Right now, the apartment market is very strong. I have a long list of buyers but a small inventory," she said.

"It's been a busy year. During the first half (of 1999), there were over 3,000 apartments sold, citywide. That's over $100 million in real estate."

The local market for buying apartments as investments is tight for several reasons. First, investors have money. "There's money flowing into real estate as investors try to diversify from the stock market," Mr. Lockard said.

Mr. Thiemann agrees "I intend for my (retirement) to be in bricks and mortar."

Second, low interest rates make financing attractive.

Third, there are some unique factors in the Cincinnati market. About 2,500 apartment units are built each year in the region -- a small number compared to cities such as Columbus or Houston, which are adding thousands of units every year, Mr. Lockard said.

And for some time, the big developers of apartment buildings locally have been Drees Co., Towne Properties and Hills Communities, Mr. Lockard said. Those companies tend to hold onto their properties, meaning not many are put up for sale.

And generally, with a lack of good buildings to buy, investors aren't trading up as much, selling smaller buildings for larger ones. "Sellers have little incentive (to sell), both in terms of tax reasons and because properties have been performing well. The scales have been tipped for them," Mr. Ciolino said.

Steve Thiemann is finding that's true. He and his father sell very few units because "there's not enough good stuff to replace it. We could sell, but we can't find something as good, so why sell?"

Just because prices for buildings are going up, that doesn't mean rents will, brokers say. Average rent increases in the first half of 1999 were just 2 percent, lower than in previous years, according to a CB Richard Ellis survey.

Vacancy rates area-wide are about 4 percent, according to a new survey by Gem Real Estate Group. That's tight, but not so tight that renters can't find another place to live if their landlords raise rents. And with interest rates low, making home mortgages affordable, many apartment dwellers can just buy a home.

"In the end, the markets will decide what the rents are," Mr. Ciolino said. Landlords might try to raise rents, and "new owners generally bring new enthusiasm and new money. Often, they'll improve properties and make it worth the increase in rent."

Biggest sales Here are the largest apartment complex sales so far this year in Greater Cincinnati.

Property Location Date Price Units Arbors of Montgomery Deerfield Township October $15.6 million 264 Normandy Green Florence June $8.3 million 204 Chestnut Hill Square Hyde Park February $8.2 million 119 The Bluffs Covington February $7.6 million 160 Derby Ridge Lakeside Park, KY March $5.5 million 240 Mont. Michel Apartments Clifton April $5.2 million 156 Source: David Lockard, CB Richard Ellis brokers

Howard, top, and Steve Thiemann of Thiemann Realtors pose in front of one of their many owned properties, Colonial Square Apartments atthe intersection of Werk Road and Queen City Avenue in Westwood.
LOAD-DATE: July 22, 2003

Evidentiary Exhibit Number 107

Business Dateline;
Business First-Louisville
September 3, 1999
SECTION: Vol 16; No 4; pg 38
LENGTH: 1244 words
HEADLINE: Depressed housing offers returns for local investors
BYLINE: Mary Ellen Hill
DATELINE: Louisville; KY; US; South Central
BODY:

Investing in depressed residential real estate is an attractive option to a number of individuals in the Louisville area. Some pursue it as a personal venture, while others operate on a larger scale, making it a full-time occupation.

What's involved? Basically the idea is to purchase residential buildings -single-family homes or multifamily apartment buildings - that have fallen into a certain level of disrepair and therefore lost value. Often they are located in areas that are less than desirable and that have low property values overall.

"The key is to find them in blighted areas that have the potential to turn around," said John Grantz, who works in sales for the Public Radio Partnership in Louisville and also currently owns and rents nine buildings, some on his own and some with partners.

Chris Dischinger, co-owner of LDG Development LLC in Louisville, said he and partner Mark Lechner founded the company in 1994 after each had a number of years experience investing in residential real estate on their own.

Dischinger said LDG now owns and manages nearly 500 properties. Most are singlefamily homes, though the company does own some apartment buildings, too, and most are in the Louisville area, though a few are in Lexington and Indianapolis. The company also does new construction.

"We've been involved in all areas of town and all price ranges, from buying a house for $ 5,000 or $ 10,000 and putting $ 20,000 into it, to one in Indiana that was a $ 200,000 property," Dischinger said.

Depressed properties bought for investment value almost always require repairs, some needing minor cosmetic work only, others needing complete renovation.

Grantz said he looks for properties "that have not been kept up but that are structurally sound, that just need cosmetics and maybe mechanics."

"We try to add value through taking something depressed, renovating it and bringing it up to market standards," Dischinger said.

After fixing up the properties, investors might choose to keep them and rent them over a long period of time or they might decide to sell them.

Mike Tabler, sales and leasing manager for LDG, said, "We started buying properties in need of major attention. We sold a few, or we would buy them, fix them up and rent them as an investment."

Investors who choose to keep and rent their properties might choose to manage them themselves or hire a management company to do the rent collection and maintenance work.

Art Geissler, a Realtor who also works for RE/MAX Properties East in Timberwood Circle in Louisville, is doing residential sales as well as sales of investment properties.

He has been investing in residential real estate since 1983 and now owns numerous properties. He also works with clients to teach them his strategy of real estate investing and how they can use real estate investments to "fund their futures."

Although Geissler manages his own properties with the help of his wife, who .runs the business part of it, collecting rents," he said there are plenty of good property management companies in town.

"There are some very good ones, and some very bad ones," he said. "If you use one, find a good one."
Investments and returns

So what results are investors achieving? Todd Ising, a full-time real estate agent for RE/MAX Properties East, began investing in real estate when he and his wife moved back to Louisville from Bermuda about 11 years ago.

Ising estimated that he has purchased about 25 houses, most of which he has renovated and sold. "We have kept a few for rentals, usually smaller ones, because they're not so much a risk factor," he said.

Ising's first project was a two-story house on Alta Avenue in the Highlands. "We moved into it and fixed it up," Ising said. "We bought it for $ 65,000, put about $ 30,000 into it, and sold it for about $ 129,000."

In a later project, Ising bought a house on Douglass Boulevard, also in the Highlands, for $ 130,000, spent $ 40,000 on renovations and sold it for $ 230,000.

Though that was definitely a positive outcome, the house right next door on Douglass recently sold for $ 425,000 just four and a half years after Ising sold his.

'That house was fewer square feet, but it was fabulous," he said.

'This is a good business," Geissler said. "People can make some money at it."

Geissler said accurately estimating the postrenovation value of a property is crucial. "The key to me is knowing the rear end value, what it's worth after you do what you do to make it marketable," he said.

One investment plan

In 1983, Geissler bought his first property, and it serves as an illustration of his method of real estate investing.

Geissler said his is one strategy out of many, but it has proven quite successful for him.

He said the price of the property he purchased in 1983 was approximately $ 49,000. "I put $ 17,000 cash down, and the owner carried the note (owner financing) for $ 32,000 for 6 months, so no bank was involved yet, and I put renters in it for $ 1,100 a month," he said. "I thought the rear end value would be $ 75,000 with $ 6,000 of work done to the property over the six months. It turned out the property appraised at $ 80,000. 1 wanted to get my $ 17,000 back and pay the seller off, so I went to the bank and got a mortgage for $ 64,000."

Banks will loan clients up to 80 percent of the appraised value of a property; 80 percent of $ 80,000 is $ 64,000, Geissler said.

"So I paid the seller off with $ 32,000 and walked away with $ 32,000 cash. And I had rent rolls of $ 1,100 each month, which I used to pay the monthly payment on the $ 64,000 debt at the bank," Geissler said.

Basically then, Geissler had gotten his initial investment of $ 17,000 back, as well as an extra $ 15,000, and was collecting enough rent each month to make his mortgage payments, so he achieved ownership of this building without any long-term capital investment.

Accurate estimations lead to success

The key to the success of this deal, and of any deal, is the estimation of the final appraisal, Geissler said. "You have to know what it will appraise for," he said.

Geissler also noted the importance of avoiding a high appraisal. Though that might enable an investor to get a bigger loan from the bank, it makes it harder to sell the property for the appraised value, if that value is artificially inflated.

"You don't want a friendly appraisal where the appraiser makes it a little higher so you can get a few extra dollars in your pocket," he said. "Because then if you need to sell it, you can't sell it for that much, and you have to wait for the market to catch up. So the trick is not to overextend your appraisals. You have to be able to get your money back out.

"Basically, you never want your debt and cash investment together to be more than what you can sell the house for," he said.

Geissler also noted that rent earnings increase about 4 percent each year. He said he currently is charging $ 1,450 each month for a property for which he collected monthly rent of $ 600 in 1983.

When renovating a property, Geissler said, keeping its value in line with others in the neighborhood is crucial.

"Do not exceed the par value in the neighborhood. You don't want to have a $ 65,000 house in a $ 40,000 neighborhood," he said. "You don't want to wind up with a Cadillac in a Chevrolet neighborhood. If you maintain the par value, rental property in Louisville will double in value in eight to 10 years."

GRAPHIC: Photo

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The Boston Globe

August 8, 1999, Sunday ,City Edition

SECTION: MAGAZINE; Pg. 18

LENGTH: 4582 words

HEADLINE: A house divided;

As cousins multiply and property values rise, the dreamy summer home of childhood memory can turn into a family nightmare.

BYLINE: By David Arnold, Globe Staff

BODY:

It is the mid-1920s, and Ike Norton is sitting on a nifty piece of Martha's Vineyard property. Less than a half-acre, 91 North Water Street is a prime lot on the harbor, with a three-story brick-and-clapboard house, two boathouses, and a pier, all just a few minutes' walk from the center of Edgartown. Norton calls it the Homestead. His grandfather William Norton bought the property back in 1866 for just $1,500. The value is probably 10 times that now, his friends tell him, what with the 50,000 summer folk coming to the island as the '20s roar on.

But Ike Norton sniffs at the temptation to profit from his land. "Place isn't worth a dime and never will be," he likes to say. "That's because it'll never be for sale."

Ike Norton, who became a local fishing legend and died in 1971 at the age of 69, was an entrepreneur blessed with many skills. Clairvoyance was not one. The Homestead destined to remain "forever" in the family was sold for $1.75 million two years ago, and the smoke is still clearing from a legal battle among his three grandsons. They shared the inheritance of the Homestead but could not find a way to share Ike Norton's dream.

Harrison Flynn of Boston and Paul and Norton Flynn of California were fifth-generation owners who had spent part of their childhoods at the Homestead. Their mother, Ursula Norton Flynn, was Ike Norton's only child and heir; she died in 1992, leaving her sons the property and all the challenges of comanaging a valuable piece of land on a tony island. They did not prove equal to the challenge.

Court documents indicate that the first shot whistled over Norton Flynn's bow via a letter from Harrison dated March 3, 1993, one year after their mother's death. "[I] would be willing (and would prefer) to sacrifice monetary gain to keep the house as our grandfather wished, but I won't tolerate the behavior you've exhibited over the past month," he wrote, not elaborating on what that behavior had been. "And if you can't act like an adult, then we'll just unload the house and go our separate ways. . . . You owe me an apology for the nonsense you said to me on the phone, and you can be sure that I won't be putting you up in Boston again until it's forthcoming."

The records also give Norton's version of events a month later, when he had traveled from California to Edgartown. He was expecting to permanently move his young family into 91 North Water Street, a 150-year-old house with six bedrooms, three bathrooms, and wraparound porches well suited to the pursuit of leisure. But the house was already full, it seemed: "Each time I called the Homestead, there would be lots of people sounding like they were having a party. They claimed to be friends of Harrison. It hurt me that Harrison had turned the Homestead into a party house. . . . When I arrived at the house, Harrison physically attacked me, and I filed for a restraining order, and criminal charges of assault and battery were filed against Harrison."

And that was just the beginning.

Flynn v. Flynn is a painful family tale reduced to a 2-inch-thick legal docket in Dukes County Probate Court. It speaks to every benefactor's nightmare, that a legacy intended to foster family unity becomes the bomb that blows the family asunder.

"People just don't understand how the dynamics of inheritance have changed," says Steven Small, a Boston estate attorney and author of Preserving Family Lands. Every day from now until early in the next millennium, some 9,000 Americans riding a demographic curve will be turning 50. No, they are not all on the verge of inheriting multimillion-dollar gems on Edgartown Harbor - or, for that matter, the 450-acre, 43-room Hudson River estate called Rockeby, or the 1,400-acre Shelburne Farms on Lake Champlain built by the late Lila Vanderbilt Webb's family. But more than a few 50-something midlifers expect to inherit grandpa's modest hunting camp in Rangeley, Maine, or the cabin on Lake Willoughby in Vermont. And if they have not already done so, yesterday's children, poised to make the big inheritance catch, are about to learn the hard realities of generational arithmetic.

Say your hypothetical New England ancestor was cruising the rustic Maine coastline in 1890 for a summer home site, and found the perfect island retreat. He purchased, built, married and multiplied, having three children who each had three children, and so on. Even assuming that the nine grandchildren have worked out their personal and financial relationships to the house, there are 81 cousins in the fourth generation, deep into midlife and preparing to inherit.

In real life, the scenario is not usually so dire. But it doesn't take 81 cousins to start a fight. If the house is grand and the property prime, it may be worth millions: Do the heirs keep it or cash in? If the property is a maintenance nightmare, and the heirs are not rich, and estate taxes are due, family harmony will surely be tested. Even if money is not an issue, even if the heirs love one another and their house, they may disagree over improvements, whose family gets first pick of vacation time, or that thorny issue of upgrading the decor of ghosts - to replace, or not to replace, the old porch cushions now packed hard as cork.

Thousands of New Englanders of greater and lesser means face such situations today, estate planners and historians point out - often because of decisions made a century or more ago when land and labor were cheap and the American population was one-fourth the 270 million it is today.

"Amazingly, you must look all the way back to the post-Civil War era to understand the convergence of developments that put these houses on the map," says William Fowler, director of the Massachusetts Historical Society.

One of those developments was the 19th-century back-to-nature movement championed by landscape painters such as Fitz Hugh Lane of Gloucester. Another was urbanization: Along with the industrial growth of Boston, New York, and Philadelphia came a phenomenon the farmer had never known, the summer vacation. And there was new wealth, some of it from the relatively recent practice of corporate merging. Along with the upward mobility there was new literal mobility as well: Steamship lines were opening at an unprecedented rate - 12 new passenger lines in 1890 alone along the Northeast coast, according to Commerce Department statistics. In 1902, 6,026 miles of railroad track were laid nationwide, an annual record that stands today.

With more time and more money came yachting, and men on sailboats found retreats on islands where they could mimic, with less money and far more modesty, the thriving grand summer lifestyles of the Pulitzers and Vanderbilts, to name two. Boston real estate broker James Murray Howe was sailing when he stumbled across Islesboro Maine, in Penobscot Bay, as was Dr. William F. Weld of Brookline (a distant relative of the former Massachusetts governor) when he was smitten by North Haven, Maine.

They were the "new" old money made from investments, shipping, and mergers. Proud to call themselves "rusticators," they built shingle-style houses designed to weather with the land, not crown it like the mansions of Newport and Bar Harbor. As subsequent generations added bodies to the family, issues of time sharing surfaced. Half the family might come in July, the other half in August. The house became sacred space, shared with the departed. Nobody talked of selling it.

For the current generation of inheritors, all that has changed. Money is a large factor in the equation, says author and attorney Small - and it's not just a question of sentiment versus greed. "At the top of the list" of problems for heirs, says Small, "are the estate consequences of a real estate market that has shot through the roof."

In the past three years, realtors say, the median price of a single-family residential home on Martha's Vineyard has increased 28 percent. Since 1996, more than 105 homes on the Vineyard have sold for amounts in excess of $1 million. A home on North Bay Road in Osterville that cost $1 million in 1994 costs $4 million now - if you can find one for sale. And the owner who bequeaths such a home without the benefit of estate planning is typically leaving the heirs a tax bill for as much as 55 percent of the property's value. It is not unusual for children to have to sell the house just to pay the tax. If they can leap the estate-tax hurdle, they have to pony up for maintenance, which can reach $50,000 or more annually on large older homes.

In some families, though, money is the least of the issues. "Families can speak passionately about their inherited land," says Jerry Bley, owner of Creative Conservation, a land-use consulting firm in Readfield, Maine. When that passion puts them at odds with one another, he adds, "it is very painful to watch."

George Carey of Tenants Harbor, Maine, a member of an extended family that owns several islands and more than a mile of waterfront at the entrance to Penobscot Bay, can testify to the bitterness of a family feud. "I've got cousins who still don't talk to each other," he says. Carey's maternal grandfather, Philip Lees Smith of New York City, made a fortune in investments earlier this century, allowing him to vastly expand a modest summer foothold on Hart Neck, a large peninsula on the south side of Tenants Harbor.

Subsequent generations subdivided the property, and to defray costs, some of those subdivision owners sold a portion of their land to friends outside the family. And there began the rub. Did those owners not related to Philip Smith have rights to communal facilities such as the dock and the tennis court? Complicating the matter, some of the people who had sold to outsiders sided with them, not kin. According to Carey, the blister ruptured in a court battle a half-dozen years ago, the upshot of which was this: Only the descendants of Philip Smith could use dock and court. It all makes Carey wonder if there are not more important issues confronting mankind. "This is a family that had been given so much in the first place," says Carey, a retired college professor. "Yet it was never enough. It never is. Someone always seems to be afraid someone else is getting the better deal."

Such was the case with a large property on a New England island not long ago. The two owners, who requested anonymity, solved their sibling dispute with cash, thus keeping their laundry out of court and the public record.

When the last of their parents died three years ago, the two children inherited not only the handsome million-dollar-plus summer home but several hundred thousand dollars' worth of securities apiece. Problem was, before the next summer season arrived, the net worth of one child's securities had multiplied, while the other's had foundered (relatively speaking). This was construed as unfair.

The "shortchanged" heir insisted not only on the pick of weeks for summer occupancy but also on the pick of bedrooms. Otherwise, she threatened to force a sale of the house - something her father, assuming the

children shared his passion for the property, had not foreseen. The matter was resolved with a cash payment in six figures to the "disadvantaged" heir, reestablishing for the moment financial parity. The status of affection between the siblings remains less resolved.

How many inherited-property family disputes in New England actually end up in court? "Probably no more than a handful a year that I personally hear about," says David Rosen, a staff consultant on property preservation issues at LandVest, a high-end real estate firm in Boston.

Brita Holmquist hails from one of the many families that saved a home without litigation: Her tools were compromise and a chain saw. Longledge was a rambling clapboard home located on Gilkeys Harbor in Islesboro, Maine. When who got stuck in what wing became an issue a few years back, the family sawed the house down the middle with a 3-horsepower Dahl, moving half of Longledge a few hundred feet away to a perch that is now called Upper Shortledge. "The reward is the utter predictability and safety that come with owning an island home that has been preserved," says Holmquist, a 49-year-old artist. "I smell the fireplaces that I smelled at age 2" - which, she notes, is not all that difficult, since they never drew properly. "Almost all my art comes from there."

Shelburne Farms in Shelburne, Vermont, is an another unorthodox success story. The 3,800-acre gentleman's farm, with a mansion and barns considered to be some of the grandest and most fanciful in the country, was built with the $10 million inheritance William Henry Vanderbilt left to his daughter, Lila, in 1885. Seward Webb, Lila's husband, put the $10 million - slightly more than the budget of New York State that year - into building the farm.

Marshall and Alec Webb remember the day in 1970 when it almost slipped away. Their father, Derick, Lila and Seward's grandson, called the children to his side and said he was deeply in debt. He would be selling off large tracts of the farm. "And he had decided to let the buildings fall down," recalls Alec, 47. So the six kids cut a deal with Dad. If he could hold out for just a few years, i.e., attend to the barns, they would all return to the homestead and work the farm.

Alec and Marshall Webb, both then in their 20s, moved to the Vermont farm with their wives. Before Derick's death in 1984, they sold some land to raise working capital that eventually allowed them to open an inn at the old mansion and start a nonprofit environmental education center. Today the farm operates with 38 full-time staff members and a $3.5-million annual budget. Some 120,000 students and visitors come to the farm each year, to hear the Mozart concerts at the inn or stay in rooms that cost as much as $260 nightly. The buildings not yet refurbished with a recent $17 million capital campaign are slated for repairs after the next fund-raising campaign.

"The farm is not in the family," says Alec. "The family is in the farm."

Still, with the transfer of property taking place at an unprecedented rate - baby boomers are inheriting $8 trillion in real estate and other assets from their parents, according to federal estimates - disagreements are sure to multiply. Rosen echoes the sentiments of Bley on the subject of preparing for inherited land. "The biggest pitfall," he says, "is to do nothing at all."

The house at 91 North Water Street, Edgartown, Massachusetts, shows just how bad "nothing at all" can get.

Ike Norton's 1971 obituary notes that "many of [Edgartown's] memories are of him in relation to the family home, boathouse, and wharf on North Water Street. Here Captain Ike lived in the character of the old Vineyard

breed." He took pride in being able to trace his ancestors back to one of the first 10 families to settle Edgartown in 1641.

In 1955, Ike Norton's daughter, Ursula, married Navy Lieutenant Harry Flynn, an island-born theater aficionado who had been educated at Andover and Harvard. The Navy took them to Newport, Rhode Island. But Harry Flynn's interest in Hollywood eventually led the couple to California, where Harry worked for a film promotion company and Ursula gave birth to three sons. When the couple divorced in the early '70s, Ursula moved back to the Homestead with the boys, who grew up in the house and later summered there.

Harrison Flynn, 41, lives in the South End. Norton Flynn, 40, lives on Cape Cod and is between jobs. Paul Flynn, 38, lives in Los Osos, California, where he gets up at 2:30 a.m. on weekdays to drive a bread truck. "It has been a Shakespearean tragedy, filled with a lot of pain," says Paul, the only Flynn brother who agreed to be interviewed, albeit briefly, about the sale of the house. He has legally sided with Harrison.

Ursula Flynn died on June 5, 1992, without a will, so 91 North Water Street was passed in equal shares to her three sons. For Norton, who was living in California with his wife, Nancy, that wasn't good enough; he believed the house should be his because, according to one court document he filed, his mother loved him best. Within a year, he would challenge the property disposition.

"Many times during Ursula's life, she specified that she did not want Harrison to have an interest in the Homestead and that she had contact with the attorney and trustee of her trust to draft a will to designate Norton as the sole heir of the Homestead," Norton said in an affidavit. But she never put it in writing, according to the attorney and trustee.

Within a month of Ursula's death, the brothers agreed to rent the Homestead for that summer. Just the rental of boat slips on the pier could bring in $10,000 a summer. The monthly rental of the house was expected to fetch $15,000, maybe more. There was much maintenance to attend to. Harrison would manage the house account and split any profits after expenses. But there was not enough time to rent for the summer of '92, and by the following winter, it was apparent that Harrison and Norton's relationship was beginning to unravel.

Norton announced that he was moving with his family back to Edgartown and into the Homestead.

"You would have been welcome to live at North Water St. with your family [during the off season] . . . but we all agreed that it had to be rented for the summer of '93, and that time has arrived," Harrison wrote Norton in early March.

Not dissuaded, Norton showed up on the Homestead doorstep a month later. Harrison, apparently living both in Boston and Edgartown, met him at the threshold, and the brothers ended up in a fistfight. The police were called and restraining orders were filed. Eventually, the brothers reached a compromise. Norton and family would move into a nearby cottage that had also been owned by Ike; Harrison would rent the Homestead to others for the summer of 1993.

When fall arrived, and the Homestead was no longer rented out, Norton wanted to move himself, his two children, and his pregnant wife to the larger house. But Harrison and his friends were apparently enjoying the place themselves on weekends. So it was not until more than a year later, on a quiet winter's day in January 1995, that the Norton Flynns moved into the Homestead. Harrison countered long distance from Boston by canceling the Ho§anc0000mestead's telephone service.

Now, events really started to get nasty. In May, Harrison and the third brother, Paul, who had been monitoring the battle from the other coast, petitioned the court to cleave their shares of the property from the

whole - a formality, because local zoning regulations prohibit such reconfiguration of a relatively small lot. What they were really doing was forcing a sale of the property. Norton could not afford to buy them out.

That summer, Harrison had also rented the Homestead for August to a wedding party from Texas. Norton, hunkered down on the third floor with his family, had missed the deadline for clearing out of the house. This did not please the bride-to-be when she arrived. The police were summoned.

Norton's wife, Nancy, would later report: "The officer told us that the [bride] had told him I had threatened to ruin her wedding. One of the women [in the wedding party] called me a 'psycho' several times. . . ." The Norton Flynns eventually left, the wedding took place, the Texans flew home, and Norton slipped his family back in.

The following summer, June 1996, the three brothers agreed to list the property with several brokers and accept the first bid over $1.5 million. Norton was supposed to make plans to leave the Homestead, but he didn't budge. Nobody met their price on the house until April 1997, when Harold Garvey, a real estate broker on the island, offered $1.65 million for the property. Norton would not sign the purchase and sale agreement, though, forcing his brothers to file a legal petition to have their agreement enforced. Then Norton attempted an end run, conveying his one-third ownership to his wife in hopes of foiling the sale.

It was at about this point that Judge John P. Cronin of Dukes County probate court, who had seen more than enough of the Norton brothers, began showing his weariness. "After reviewing the evidence presented by [Norton] at approximately five court Hearings over the course of two years, I . . . believe his motivation is to cause delay and interfere with any sale, lease, or other action which would interfere with his continuing to live rent free at this unique waterfront property on Edgartown harbor," Cronin wrote in a decision that denied Norton's petition to void the sale.

Less than one month later, at 31 minutes past 3 p.m. on July 25, 1997, the Dukes County registrar of deeds recorded the transfer of ownership of 91 North Water Street from the Flynn brothers to the North Water Street Realty Trust, Harold Garvey, trustee. The end, it seemed, of a painful saga.

Not quite.

Unbeknownst to Norton Flynn, and probably his brothers, on the very same day the deed was logged at the registry, Garvey accepted $1.75 million - $100,000 more than he had paid the Nortons - from a Lincoln couple who became sole beneficiaries of the trust, and thus owners of the house. Norton cried foul, accusing Garvey of misrepresentation and petitioning the court to rescind the sale. Earlier this year, the petition was denied. The end, again - if no further petition is filed.

Bailey Norton, Ike's nephew, lives across the street from the Homestead. On a second-floor wall in Bailey's home hangs a small watercolor painted in 1925, its mood calm, warm, and lazy. The picture speaks in soft tones of a hot summer day on Edgartown harbor when there were no houses across the way and the wooden boats were rigged for work, not play.

The painting's perspective extends out Ike Norton's pier, past two young boys lazing in the sun's heat. Captain Ike's sloop Catherine is docked at the end of the pier. A harpooner's platform has been temporarily rigged on the bow; that means the swordfish must have been in, so it must have been August. Is that Ike on board, one of three figures in the cockpit? The brush strokes are too broad to show the round gold-rimmed glasses that would have been the giveaway.

On a day this summer as sultry as the one depicted in the watercolor, Bailey Norton decides to stroll down the short path to the wharf where he docks his powerboat. Lean and tanned, he wears khaki pants and an

Edgartown Yacht Club polo shirt; his attire, like the furnishings in his house and boat, is in perfect order. The leap he will shortly make from pier to boat suggests that for his 79 years, he is also in perfect shape.

As Bailey crosses the yard, the soles of his canvas sneakers crunch on the broken white shells marking the path.

"This is where Ike used to put the shells after he shucked the oysters he had caught," Bailey explains. His gaze lifts to the end of the dock where Ike moored a succession of boats - Catherine, Malvina B., Ursula, Flamingo, Edgartown, Ike & Jens, Joan and Ursula, Hunter, to name a few - each vessel larger than the last.

Of the recent unpleasantness involving his second cousins, Bailey has little to say. Silences speak to the discomfort of a sad matter - a family matter. "At my age and experience, I have come to realize that things are not going to be as they used to," Bailey says. "I had hopes, but times change, one has to be practical."

And then he starts talking about fishing.

All in the family? Don't count on it

So you want to bequeath the hunting camp on the small Maine lake to the three kids. The first question estate planners recommend you ask is: Are you sure?

Like a family business, a second home is unlikely to engender in heirs the passions of those who created and sustained it. One sibling may be living in Kansas. Another may have vowed a life of privation and lack the means to contribute to the new roof and sill. Some families may decide that the best way to avoid acrimony is simply to sell the place and divvy up hard currency, not a dream. Then again, the family may find the prospect of condominiums on a shorefront once inhabited by loons so distasteful that preservation is worth the skirmishing.

"The most important thing a family can do is to talk," says Ronald Garmey, an attorney and estate planner with the Boston firm of Hutchins Wheeler & Dittmar. For $2,500 to $5,000, Garmey says, a good estate attorney can help a family develop strategies to minimize interference from Uncle Sam and avoid major management ruts down the road. Garmey and others offer these suggestions as guidelines only:

- Determine the property's value. An authorized appraisal that the Internal Revenue Service will honor is best. The charge is generally $1,500 and up, because the job is usually done by an attorney.

- Upon the death of the second parent, $650,000 of an estate can pass to heirs untaxed. But Uncle Sam will take up to 55 percent of the value of an estate (houses, securities, wedding rings, etc.) above that exempt limit, and many an attorney says that only a fool pays the full estate tax. One of the most common tools for skirting the tax is the qualified personal residence trust. Basically, this legal instrument allows a parent to transfer ownership of a primary or secondary residence to the next generation at significant tax savings. The downside, from the parents' perspective, is that they may end up paying rent to the children - or in a worst-case scenario, which some lawyers have witnessed, getting evicted.

- For subsequent generations, there are many forms of ownership in various trust configurations that can help siblings and cousins steer clear of fisticuffs and court battles to sort out how the property will be managed and under what circumstances interests may be sold.

- To reduce expenses and raise income, there are several imperfect alternatives. For instance, owners can rent, sell a portion of the property and place the capital in a maintenance fund, open a bed and breakfast, or donate the property to a nonprofit organization while maintaining tenancy for life (which avoids estate taxes but leaves nothing to the next generation). An owner can also make a conservation easement, which permanently

deeds development rights to part or all of the property to a nonprofit land trust. Ownership does not change with such an easement, but the value of the property usually drops when part of it is stripped of development potential. As of a 1998 census, nearly 7,400 such easements nationwide had been made to protect 1.4 million acres, an almost fourfold increase in acreage from 1988, according to the Land Trust Alliance. Massachusetts, with 700 conservation easements, trails only Pennsylvania (743) among the states with easements held by land trusts.

- Put as much as possible in writing in a will or codicil (which modifies a will). Don't leave the heirs guessing.

Some organizations offer specific guidelines to help family members find a peaceful route to saving the homestead. They include LandVest in Boston, the Maine Coast Heritage Trust in Brunswick, Maine, Creative Conservation in Readfield, Maine, and Boyce-Abel Associates in Santa Cruz, California.

GRAPHIC: PHOTO, 1. PHOTOGRAPH BY LANE TURNER / THE BOSTON GLOBE/FACING PAGE: IKE NORTON'S FORMER HOMESTEAD AT 91 NORTH WATER STREET IN EDGARTOWN. THE LEGAL AND PERSONAL FEUD OVER THE MARTHA'S VINEYARD PROPERTY, SAYS ONE GRANDSON, "HAS BEEN A SHAKESPEAREAN TRAGEDY, FILLED WITH A LOT OF PAIN." CLOCKWISE FROM ABOVE: A 1925 WATERCOLOR OF NORTON'S PIER AND SLOOP; A PHOTOGRAPH OF NORTON'S FATHER, WILLIAM, CIRCA 1940, BY ALFRED EISENSTAEDT; AND A PORTRAIT OF IKE NORTON (RIGHT) AND HIS BROTHER SAMUEL.
2. Painting and photographs courtesy of Bailey Norton
3. MARSHALL WEBB AT SHELBURNE FARMS IN VERMONT, A FORMER FAMILY HOME THAT, THANKS TO FAMILY COOPERATION, HAS BEEN PRESERVED. IT NOW INCLUDES AN INN AND A NONPROFIT ENVIRONMENTAL EDUCATION CENTER. "THE FARM IS NOT IN THE FAMILY," SAYS MARSHALL'S BROTHER, ALEC. "THE FAMILY IS IN THE FARM."
4. On the cover: A home on Martha's Vineyard that was inherited by three brothers, spawning a seven-year feud./ Photo-illustration by Lane Turner The Boston Globe

LOAD-DATE: August 10, 1999

Evidentiary Exhibit Number 109

Dallas Observer (Texas)

July 29, 1999, Thursday

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HEADLINE: Old business;

Small-time antiques dealers find themselves out in the cold

BYLINE: Felicia McCarthy

BODY:

The sudden, unexpected death of Maurice Levy's Knox Street antiques business came early July 8, while he was on a roof, repairing an air conditioner.

Marcie Williams, the manager of Knox Street Antique Mall, delivered the news with a phone call.

"She told me that Keith Cecil came early in the morning and put up two signs saying that the mall was closed, and that I needed to make arrangements to move my merchandise," Levy recalls. The 62-year-old air-conditioning contractor sells fine estate jewelry and watches as a side business.

The closing came as a shock to Levy and other merchants at the mall. When his tenants paid their July rents, Keith Warren Cecil III, the landlord who leased space to dealers at 3319 Knox St. and at the Windsor Antique Mall in Preston Center, gave them no hint that the shops were in trouble.

No hint, that is, except a history of bad debts and troubled finances that his tenants were unaware of until Cecil's past caught up with them. Now, when it comes to collecting the rent they paid Cecil and the money he owes them from sales of their antiques, some fear they may be out of luck.

To Cecil, shutting down the two malls is just business--closings happen--but the 100 or so small dealers tossed out of Cecil's malls on July 8 are left contemplating another lesson: Let the tenant beware.

Like most antique dealers, Levy conducts business out of a mall because it affords him the convenience of owning a retail business without the red tape. In exchange for rent and 6 percent of his sales, Levy received space to display his merchandise at Knox Street Antique Mall. Cecil's company took care of hiring a full-time staff, advertising and promoting the mall, and paying the sales taxes on merchandise sold. Twice a month, the mall issued checks to the dealers for their sales.

Three days after Cecil collected rent for July, the malls went out of business. About the same time that dealers were told to remove their merchandise from the buildings, they also heard that checks issued for goods sold between June 15 and June 30 were bouncing. When they rushed down to First National Bank of Park Cities, the bank where the checks were issued, they learned that the escrow account where their money was supposed to be deposited had been closed by Cecil.

The only communication most dealers had from Cecil about the closings were signs posted on the malls' doors, instructing them to call his lawyer W. Michael Read with any questions.

Barbara Falk, a dealer at Knox Street, says Read told her that Cecil's company had been evicted from the building that housed Windsor Mall, which Cecil leased and then sublet to dealers. After being evicted from one, he decided to close both. Before Read could tell Falk anything else, he said, he would need to speak with Cecil. Several dealers who spoke to the lawyer said he appeared "clueless."

Read says that he was aware that Cecil would be closing the mall but that he was unprepared for the multitude of phone calls he would receive. He began representing Cecil's corporation, 6126 Luther Lane L.L.C, after Cedar Springs Realty, the company that owned the Windsor Mall location, took Cecil to court for unpaid rent and taxes that originated with the mall's former tenant, Windsor Antique Mall L.L.C. From the time that Cecil acquired the Windsor Antique Mall in February 1998, he had been in dispute with the realty company about the lease agreement, arguing that he was not responsible for the former tenant's debts. Cedar Springs Realty disagreed, and convinced a court to issue an eviction order in late June.

To appeal the decision, Cecil was required to post a bond of $24,600. He decided to call it quits instead.

"Now, I decided I'm not going to put $25,000 more into this store, so I said, 'I'm tired. I'm tired of messing with these people. Let's shut them down,'" Cecil says. "And that's what I did."

Cecil says that he decided to shut the Knox Street mall down as well because he believed that fickle dealers would leave once they heard he had been booted out of the Windsor space.

Cecil's abrupt decision to get out of the antique-mall business has created much work for lawyers in the last few weeks. Several dealers say they are consulting attorneys, issuing demand letters, and considering filing a criminal complaint if Cecil does not pay what he owes them.

But, judging by his history, the dealers may need more than a few letters and angry phone calls to get paid. According to court records, Cecil has been sued twice for nonpayment of debts totaling more than $10,000 and once for writing a bad check in the past 10 years. In 1990, the IRS filed a tax lien against business property he owned in the 2700 block of Fairmount. Cecil filed for personal bankruptcy in 1994 and says that he now is exploring that option on the corporate level.

Cecil says that to date he has received only three demand letters. Dealers say that they began receiving small checks averaging 10 percent of what Cecil owed them, but feel that's not enough.

"I'm not taking 10 percent of $3,500," says one dealer, who asked not to be named.

The rumor mill in the antique business is a constantly churning machine. After Cecil closed the malls, it didn't take long for the dealers to learn that this wasn't the first time he has closed up shop and left folks with their hands out. Cecil operated another antique mall on McKinney Avenue until he passed it on to another operator this March. Thomas Howell, a lawyer, says he and his wife, Jane, were looking for space to open an antique mall when their realtor mentioned that Cecil was in default on his lease at the property.

Jane Howell, a former dealer at Knox Street, became McKinney's new proprietor. Thomas Howell says the couple entered into a contract with Cecil under which he agreed to pay the McKinney dealers for merchandise sold the last two weeks that he operated at the space. But Howell claims Cecil paid only dealers who rented space at his other two malls.

Cecil claims that he acted within his agreement with the Howells and "all the McKinney dealers got paid."

In the end, the way that Cecil handled the antique malls reflects his dislike of the people whom he was in business with.

"These are small-time people, OK? They are not business people," Cecil says. "They decide everything on emotion, and that's another problem I had with this business. It's like running a nursery school."

Michael Cates, a dealer at Windsor, says Cecil's relationship with the dealers was strained before the closing, but he refutes the claim that he is not a businessman. He just doesn't have time to hunt Cecil down and

beg for his money. Cates was previously a dealer at Knox Street but moved out after Cecil took over the operation in 1996 in part because he believed Cecil did not promote or advertise the mall adequately.

"Keith Cecil had no business in the antique business," Cates says.

Cates can't decide whether it was arrogance or stupidity that led Cecil to collect the rent and then close the dealers' accounts, but either way he's outraged.

"I feel like other dealers," Cates says. "He's a moral and ethical pygmy. This time he crossed the lines, and he's done it with the wrong people."

Even Keith Cecil himself can't seem to explain why he closed the dealers' escrow account without allowing checks to clear first. He admits closing the account on July 8.

"Well, I thought a lot of the checks went through, and I knew that it was going to close down...I know all the rent hadn't gone in, so I consolidated all the accounts, and I still don't know what I have, but I'm trying to pay everybody."

He says those who accuse him of trying to pull a fast one are wrong, especially since they all know where his office is and how to reach his lawyer.

"I understand their feelings, but I'm in the same boat. I've lost a lot of money also, you know?" Cecil estimates that he has lost $70,000 on the antique malls. More important, Cecil doesn't see why closing the malls was a big deal.

"You're talking about antique dealers who rent space for $200 bucks a pop. Why is this a big deal? This isn't hundreds of thousands of dollars. This isn't anything like that," Cecil says.

But it's a big deal to people like Cates, who says that he received a hot sales check for $785, is owed $420 for pro-rated rent, and a $600 deposit. Multiply that times 100 dealers, and the total quickly grows. Maurice Levy says that in addition to his deposit and rent, Cecil also never paid him for more than $3,000 in air conditioning and plumbing repairs that he did on Cecil's property.

Several dealers who spoke with the Dallas Observer say they are owed money in the four-figure range. "To lose $1,400 is a real hardship," says one woman, who wished to remain anonymous. "It may not be a lot of money to Mr. Cecil, but to me it is."
LOAD-DATE: July 28, 1999

Evidentiary Exhibit Number 110

Orlando Sentinel (Florida)

July 18, 1999 Sunday, METRO

SECTION: HOMES; Pg. J18

LENGTH: 957 words

HEADLINE: GETTING RID OF A LOW-INTEREST MORTGAGE MIGHT NOT PAY

BYLINE: Robert Bruss,Tribune Media Services

BODY:

QUESTION: My husband and I are 72. We live in a triplex that has a $128,000 mortgage at 6.875 percent interest, which we'll pay off in 2014. We have about $250,000 invested in mutual funds, which we could use to pay off this mortgage now. My husband doesn't think we should pay off the mortgage, but I think we should because it would give us $1,000 extra per month to live on. What is your advice?

ANSWER: If you pay off that mortgage, you just invested your money at 6.875 percent. I hope your mutual funds are doing far better than that. Also, paying off the mortgage might leave you property rich and cash poor. Unless you badly need the extra $1,000 per month income, I recommend you refrain from paying off that beautiful, bargain interest rate mortgage.

RETHINK SELLING WITHOUT AGENT

Q: I plan to sell my home in August and want to save the sales commission. Do you have a checklist I should follow for selling without a real estate agent?

A: No, because I do not recommend you sell the house by yourself. Selling a home has become complicated, and most sellers need professional help to make the required disclosures, avoid legal problems and receive top dollar.

Before you try to sell the house yourself, interview at least three successful real estate agents who sell homes in your vicinity. They won't mind because they know most fizzbos fail, and then you'll probably list your home with one of the agents you interviewed.

The agents will explain the marketing work required to sell your home. They will also give you free comparative market analysis forms showing your home's market value.

Also, they will explain the powerful sales benefits of the Multiple Listing Service and Internet listings. Once you have this information, you can decide if you will be able to sell the home without an agent.

DON'T GIVE UP CONTINGENCY CLAUSES

Q: My wife and I have been preapproved for a mortgage, but we're having trouble buying a home. We lost two houses to other buyers. Our agent says we should simplify our purchase offers so we have a better chance.

She persuaded us not to include a contingency clause for a professional inspection; however, we're reluctant to remove the mortgage finance contingency clause, just in case the house doesn't appraise for the price we offer.

Would it be dangerous not to include a mortgage contingency clause in our next offer?

A: Yes, it's dangerous not to make your purchase offer contingent upon obtaining the mortgage you need to buy a house. What would you do, for example, if you offer $200,000 for a house and your offer is accepted, but the house then appraises for only $180,000? Can you pay the extra $20,000 if you weren't protected by a mortgage finance contingency clause?

Buying a home in today's booming marketplace can be risky if the buyer isn't protected by mortgage finance and professional inspection contingency clauses. Only you can decide if you should buy a home without those protections.

HOW TO FIND LEASE-OPTIONS

Q: In the past, you've recommended that "cash challenged" people should buy houses on a lease-option with a rent credit of at least 25 percent. I can't find any lease-options in the area where I want to rent a house and eventually buy it. How can I find a lease-option house?

A: There aren't many residence lease-options available now because the home sales market is so strong in most cities. However, you can create your own lease-option.

Read the "houses for rent" or "condos for rent" newspaper classified ads. Inspect the ones that interest you. When you find one you like, ask the landlord if he or she will lease it to you with an option to buy. Many landlords want to sell eventually, so your lease-option offer might be welcome.

To tempt the landlord, offer $3,000 to $5,000 nonrefundable option consideration money. Because the landlord was expecting a modest security deposit, your offer will be hard to reject.

You also could place a classified ad under "homes wanted to rent," such as "Executive seeks 3 BR, 2 BA house on five-year lease with option to purchase." Run that ad for a week or two. You won't get many phone calls, but all you need is one or two.

DON'T BUY IF MOVE LOOMS

Q: Should I buy a house even though I expect to move in two or three years? When I see home prices appreciating rapidly and hear about the profits my friends have made on their homes, I want to buy a modest house. But I know my employer will transfer me within a few years. What should I do?

A: Although the market values of homes are appreciating rapidly, due to a booming economy and low mortgage interest rates, there is no guarantee home value appreciation will continue at such a rapid pace. Real estate values usually go in seven-year cycles between peaks. Nothing is constant.

If you buy a house today, expecting to sell it within two or three years, you will be lucky to break even. Normal, annual appreciation in market value is only 3 percent to 5 percent, but costs of selling a home are typically 10 percent of the sales price. Unless you plan to stay in your new home at least five years, I do not recommend purchasing.

TWO STRIKES?

Q: I am on Social Security disability and receive $1,143 per month. My credit is not good because of medical problems. I have a Department of Veterans Affairs home loan entitlement that I have never used. Can I buy a house? If so, in what price range?

A: My best advice is to consult an experienced mortgage broker in the community where you want to buy a house or a condominium. He or she can give you details on the mortgages for which you might qualify. Being

on Social Security disability does not disqualify you from obtaining a home loan. However, your bad credit record might.

COLUMN: REAL ESTATE MAILBAG

LOAD-DATE: July 18, 1999

Evidentiary Exhibit Number 111

Morning Call (Allentown, PA)

May 9, 1999, Sunday, SECOND EDITION

SECTION: REAL ESTATE/HOME, Pg. G1

LENGTH: 1711 words

HEADLINE: NEW WAYS TO SELL;
INVESTORS HAVE DEVELOPED CREATIVE WAYS TO BUY AND SELL HOMES. EVER THOUGHT;
ABOUT RENT-TO-OWN?

BYLINE: BETH W. ORENSTEIN; (A free-lance story for The Morning Call).

BODY:

Joan Matura's 80-year-old, middle-of-the-row home in Northampton needed a lot of work.

But when she got an estimate for remodeling it, "it was just too high," Matura said.

Rather than sink a substantial sum into the house where she and her family had lived for 15 years, she decided they should sell and move on.

She figured she would net little from a traditional sale through a Realtor, who would take a 6 percent commission. Also it could take months until the Realtor found a buyer who wanted a fixer-upper.

Then Matura recalled seeing a newspaper ad that said, "We buy homes." She called the number in the ad.

The number belonged to Tom Rummel of Results Homebuyers in Whitehall Township. Rummel, 28, is an investor who offers a number of different ways to buy and sell property other than the traditional Realtor listing.

He buys homes for cash, arranges owner financing, or finds a tenant who will rent with an option to buy.

Rummel bought Matura's house for cash. "We haggled a little and came to a figure that we were both happy with," Matura said.

Matura was happy because she was able to use the money from Rummel to help buy an 8-year-old home in Coplay. And Rummel was happy because he has someone who is interested in renting the home with the option to buy. The tenant is a contractor and will be able to renovate the property, Rummel said.

When the tenant goes to buy the home, he could get credit for his sweat equity.

Rummel started in the real estate investing business working for his father, Fred, a Realtor in the Lehigh Valley for about 25 years and owner of the Rummel Agency in Whitehall Township. Rummel worked with his dad summers while in college and began full-time after he graduated from Muhlenberg College in 1992.

Rummel started Results Homebuyers with his father about four years ago. He works from his dad's office at 2106 S. 1st Ave.

Tom and Fred Rummel are not the only investors in the area who buy homes for cash or with lease-purchase options. But they seem to be doing it on a larger scale and more visibly than anyone else in the Lehigh Valley, said Ron Donchez, vice president of commercial lending at the Bethlehem Loan Center of National Penn Bank.

"They aren't unique, but no one is as far-reaching as they are," he said.

One of their methods is owner financing. In those cases, the seller holds the mortgage and Results Homebuyers pays him his equity in monthly installments, instead of in one lump sum as with an outright sale.

Still, other times, the Rummels buy the property under a lease-purchase or rent-to-own agreement. "In those cases, our company pays the sellers an agreed-to amount each month. We then put a pre-screened and pre-qualified tenant/buyer in the property who will live there with the intent of eventually buying the home," Tom Rummel explained. "We can offer the tenant/buyer credits, which will help them eventually to purchase the home."

The terms of a lease-option agreement are negotiable. The terms include the length of the lease, the purchase price, the amount of the monthly rent, and the portion of the rent that will be credited toward the purchase price if the buyer exercises his option. "Every case is different," Rummel said. "There is no typical amount the tenant/buyer contributes toward the purchase each month."

Such alternative selling methods, which are popular in other parts of the country, are not for homeowners who have the luxury of waiting for the right buyer and the price they want for their property. "My way is not going to work for them," Rummel said.

But those methods, he said, may be the answer for people who have a problem property. The problem could be that the property needs a lot of repair, such as Matura's home. "Even the gentleman who gave us the estimates for remodeling said sell it," Matura said.

The problem could be that the owner or buyer is strapped for cash. Or it could be that the owner is in a hurry to sell. He could have been transferred or have bought a new home and doesn't want to have to pay two mortgages while his first home sits on the market.

"With us," Rummel said, "you have a guaranteed sale and you don't have to worry about time. We're flexible." When Results Homebuyers buys a home, the company can close quickly, he said, because it has the financing and doesn't have to wait for loan approvals.

"We have no contingencies," added Fred Rummel. "The owners get their money and they're out."

The Rummels say they pay top dollar for the properties they buy with their alternative methods. Homeowners might even get more from them than they might net from a traditional sale, Tom Rummel said.

Here's how Rummel does the math: A homeowner lists his home for $ 100,000. He might sell it for $ 95,000. By the time the seller pays the Realtor's commission, taxes and other costs from the sale, and the mortgage and taxes on the house while it's on the market, he may net only $ 87,000.

For that home, Rummel may offer $ 90,000 for a lease-purchase sale. The owner wouldn't get $ 90,000 at the time of the agreement, but he would get that amount eventually when the tenant decides to buy the house.

"In that case, it may be worth it for him to consider my offer," Rummel said.

Also, a traditional sale can take months from offer to settlement. Meanwhile, the owner is paying mortgage and taxes on the property and, in some cases, may have moved to another home. Because Results Homebuyers can turn the property around in less than a month, Rummel figures the owner is "saving money because now they have income from the property" where before it was costing them money each month.

Rummel wouldn't say how much he typically offers for a property when he pays cash. But, he said, "All we want is to make some money in the process. We're not out to make a killing every time we get a property."

However, Bruce Whitesell, of the ERA Partners Group in South Whitehall Township, said a cash deal often isn't as good as it sounds. He said investors generally pay about 30 percent less than homeowners can sell their properties for on the traditional market.

Realistically, "there's got to be something in it for the (investors)," he said. "They're looking at creative terms that will allow them to make money on the difference between what they're paying the owner and what a buyer would pay them for the property."

Still, Whitesell said, even though investors may offer the seller less money than in a traditional sale, "it could be a viable option for someone who needs their cash out in 30 days or less." Also, he said, "if you have a home in bad condition and don't have the resources to make it saleable, the investor-approach may not be a terrible idea because investors typically have better access to capital than you would."

Lease-purchase deals have advantages and disadvantages to the buyer and the seller as well, real estate experts agree.

Jeff Bell, president of United General Mortgage Co. in South Whitehall Township, believes that lease-purchase is "one great way to sell your house. I did it with my house in Baltimore before I moved here," he said.

He said when a home is listed as a lease-purchase "it makes it that much more marketable" because more people can afford to buy it. They don't need cash up front, as they do in most traditional sales.

A big advantage of lease-purchase to the buyer is that he locks in a purchase price while postponing the closing, typically for a year or two, Rummel said. This method also gives the buyer time to clean up his credit if necessary and put money toward the purchase.

Bell said if tenants pay their rent on time for at least a year it enhances their chances of getting a mortgage to buy the home.

A big advantage to the seller of lease-purchase is that he knows his home is sold, Rummel said. "If he's leaving (town) today, we could get someone in a week who leases the house and starts paying his mortgage."

Leasing to potential buyers is another advantage, Bell said, because such tenants have a vested interest in caring for the property. "It's highly unlikely they will do anything to damage the homes because they have intentions of buying it someday. They'll treat it more like their own."

However, Whitesell said the seller is taking a risk because the buyers could decide not to buy the house. "If the tenant decides not to buy after two or three years and moves out, the owner is faced with an even tougher sell. If they couldn't sell it when they were living in it and it was in good condition, the chances of selling it empty and trashed are even worse."

Also, Whitesell said the owner may have moved from the area thinking his home sold. "Now you're a thousand miles away, and the value of the home is $ 10,000 to $ 15,000 less because of the condition. You're in worse shape than you were two years ago when you offered it as a lease-purchase because you needed cash and couldn't sell."

Rummel said his lease agreements state that Results Homebuyers is responsible for any damage caused by tenants. Rummel said his agency also would find another tenant if the original tenant decides not buy the home and would continue to pay the owner monthly even if the home were empty.

There is also some risk to the tenants, Whitesell said. They risk forfeiting the money they paid each month in rent that was to go toward their buying the home. Often rent-to-own tenants pay more in rent for the property than they would without the lease-purchase because the difference is credited toward their down payment and closing costs.

Sellers can place an ad in the paper and offer the property with a lease-option on their own. But if they go through an agency such as Results Homebuyers, they don't have to be the landlord. "We handle all the headaches and they get a check from us every month to cover the rent," Rummel said.
Whitesell agreed that those who are interested in lease-purchases are wise to do it through an agency such as Results Homebuyers. "The advantage to that kind of arrangement," he said, "is that you're doing it through someone who has the expertise and who can minimize your chances of ending up with the house back."

Special to The Morning Call
GRAPHIC: PHOTO by FRAN KITTEK, The Morning Call CAPTION: Tom Rummel of Results Homebuyers in front of one of his properties, 515 E. 10th St., Northampton
LOAD-DATE: May 10, 1999

Evidentiary Exhibit Number 112

The San Francisco Chronicle

MAY 5, 1999, WEDNESDAY, FINAL EDITION

SECTION: HOME; Pg. 1/Z1; REALTY CHECK

LENGTH: 1349 words

HEADLINE: How to Buy the House You're Renting;
Tenant-buyers can avoid market frenzy

BYLINE: Laurie Brian

BODY:

You've been renting a place in the Bay Area for the past couple of years, and now you're ready to buy. Yet you love where you're currently living. The sun floods your kitchen and bedroom, you have a view of the bay and your furniture suits the place perfectly -- not to mention you really like the neighborhood.

Why not start at home and explore whether you can buy the house you're renting? It could be the ideal way to beat one of the hottest real estate markets in the country.

Some Bay Area tenants have shrugged off the traditional approach to home-buying and gone straight for the gold by inquiring about the purchase of their rental property. There are both benefits and drawbacks to such a deal, but in this wild market, it's an option worth exploring.

Bay Area real estate agents say the number of renters who decide to buy their home is relatively small. These transactions make up approximately 15 percent of her business, says Christa Colombo, president of Property Concepts, a buyer's agency in San Francisco and Marin. And that's on the high side; many other real estate agents report a lower percentage.

MILL VALLEY SALE

Tom and Angela Benedict are one couple who bought the house they were renting in Mill Valley. Although their place wasn't on the market, the Benedicts asked their landlord about the possibility of buying it. They had already established a positive tenant-landlord relationship, and they were fond of the house and location. So, why move, they asked themselves, when they were perfectly happy where they were living.

Once the landlord agreed to sell, the Benedicts did some homework, got preapproved, and offered a competitive price. Since they didn't need to be taken around to see homes, they asked their lender to suggest an agent for their transaction. He recommended Colombo, who represented them through the rest of the home-buying process.

Colombo charged the couple well below the 6 percent commission that real estate agents command in most transactions. "We negotiated a flat fee with her and the bottom line was that for a fraction of the cost, we were able to get the deal done," Tom Benedict says.

The fee didn't even equal 1 percent of the sale, he adds, so "this was definitely the way to do it."

The seller was a lawyer and Colombo represented the Benedicts, and it was a smooth transaction all around.

"It's like a normal sales transaction. It's just that the buyer doesn't get caught up in the frenzy of dealing with today's market," says Barbara Callan, a real estate agent with McGuire Real Estate in San Francisco, who's worked with renters who wanted to buy from their landlords.

STARTING OUT

One of the first steps, according to Callan, is to find out if the landlord is motivated to sell. Then either do your own homework or talk to a real estate agent about putting together a competitive bid. You should also talk to a mortgage broker before you approach the landlord, to make sure you're qualified to buy.

"Like with any real estate transaction, get preapproved because it shows you're serious about buying," Colombo says.

Industry experts advise buyers and sellers going into this situation to get an objective third party involved, whether it's an agent or a lawyer.

A single agent can represent both buyer and seller, but the parties need to consider whether their interests would be best served in this way.

"If the agent is representing the buyer and seller, by law, it's a dual agency," says Colombo, adding that she encourages sellers to get their own agent to work on their behalf to make sure they are fairly represented.

"Even if the tenant and landlord are friends, the transaction should be handled in a professional manner, and discussions regarding the contract should be handled through the agent," Colombo adds.

Some tenant-landlord sales are for-sale-by-owner situations, and Jari Esterhuizen, an agent with Frank Howard Allen in Mill Valley, suggests that both parties be particularly careful in these cases.

"There is a greater risk in this type of situation because there are issues of liability," Esterhuizen says.

If the parties don't have agents, they may not understand the many ramifications of disclosure and liability. By law, sellers must disclose all "dangerous conditions" and other information to potential buyers.

Another reason to employ an agent or lawyer is the sheer amount of detail involved. "The paperwork is complex and there are many statutory documents to be signed. People who are not in the real estate business may not understand all that's involved," says Colombo.

Buyers should be careful to make a solid offer that's competitive in today's marketplace. "Be realistic about what the market is doing. If the property is worth $300,000 and you come in with a $200,000 offer, the seller won't accept it," Colombo says.

PLUSES AND MINUSES

Benefits of such a transaction abound for renter-buyers, especially since they know the property inside and out. "They know all the quirks of the house. They know where the funny creaks are and if the key in the front door jams in a certain way," says Colombo.

Buyers who purchase their rental property also spare themselves from searching for properties and enduring multiple-offer competition in the Bay Area's wild real estate market. Plus, they don't have to go through the hassles of moving.

Sellers benefit as well. They don't have to deal with numerous people trudging through the property and they don't have to sort through offers. "They don't have to go through the hoops of having the property sit vacant on the market," Colombo says.

However, there are also drawbacks for sellers. If they go directly with the offer from their renter, they don't have the benefit of today's competitive market. "They may not get the exposure on the open market or the multiple offers that push up the price," Callan says.

-- RIGHT OF FIRST REFUSAL .

When tenants first move in, they should ask for the right of first refusal, says Barbara Callan of McGuire Real Estate in San Francisco.

This means if the property they're renting goes on the market, they will have the option to match the sale price and terms of any outside offer.

It essentially gives renters a fair first shot at the property.

When a rented apartment is converted to a condominium, tenants commonly get the right of first refusal.

-- STEPS TO TAKE WHEN BUYING A CONDOMINIUM .

Renters who want to buy a condominium that's in a building with other units should read and thoroughly understand the bylaws of the homeowners association and the covenants, conditions and restrictions (CC&Rs).

Find out whether the association is involved in litigation, advises Christa Colombo of Property Concepts, a buyer's agency in San Francisco and Marin County. If there is any sort of legislation pending, it may be harder to get financing.

"It's also important to look into the building's construction and whether there are defects before you decide to buy," says Colombo. She noted that there are laws that require the disclosure of such defects.

As far as financing goes, condo buyers may be in for an unhappy surprise. If many of the units in the building are rented, lenders will be more restrictive on the financing. In condo-purchase situations, buyers may have to put down as much as 20 to 25 percent, she says, and their rates may be higher because of the rental factor.

-- RESOURCES

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-- Barbara Callan, a real estate agent with McGuire Real Estate, 2001 Lombard St. in San Francisco; (415) 929-1515, ext. 2592.

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-- Christa Colombo, president of Property Concepts, 1177 California St., San Francisco; (415) 447-1970. In Marin County: 1330 Lincoln Ave., San Rafael; (415) 456-9356.

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-- Jari Esterhuizen, a real estate agent with Frank Howard Allen, 1204 Strawberry Village, located in Mill Valley; (415) 381-3000.
GRAPHIC: GRAPHIC, Tom Murray/The Chronicle
LOAD-DATE: May 5, 1999

Evidentiary Exhibit Number 113

The Tennessean

April 5, 1999 Monday

SECTION: BUSINESS; MONEY MATTERS; Pg. 1E

LENGTH: 538 words

HEADLINE: VACATION PROPERTY IS AN ASSET

BYLINE: CANDY MCCAMPBELL

BODY:

By CANDY MCCAMPBELL

I've seen quite a few write-ups that mention new tax handling for sales of primary residence homes, but I haven't found where the rules are for sales of vacation homes and investment properties.?B?

Could you describe the current rules and how to report these transactions to the IRS?

A vacation home is an asset, no matter how you use it.

If your vacation home is strictly a vacation home, used by you and your friends, it is handled like any other asset, said Joel Abbott, customer service specialist for the Internal Revenue Service here.

"If it's only for personal use and you decide to sell it, you figure your gain or loss and report it on Schedule D," he said.

Generally, only the mortgage interest and taxes would be deductible.

You don't have to hold the vacation home solely for your own use, he said.

If your personal use "exceeds the greater of 14 days or 10% of the time the house is rented out for fair rental value, it's a vacation home," he said.

For example, if you spend four months in your Florida condo and rent it to friends for a total of another two months, you're still a vacation-home owner.

And if neighboring condos rent for $1,000 a week and you let friends take yours for $500 a week, you're not jeopardizing the "personal use" status since you're not charging fair market rent.

IRS Publication 544, "Sales and Other Dispositions of Assets," takes you through that kind of sale.

But if the vacation home is a rental property, used and maintained as such, you get another whole set of rules.

Pick up Publication 527, "Residential Rental Property (Including Rental of Vacation Homes)," for this. It takes you through reporting of expenses and how they are allocated between commercial and personal use, for example.

The sale of a rental home should be reported on Form 4797, "Sales of Business Property," that's used in conjunction with Schedule D.

Storm fallout: The tornadoes may have roared across Nashville almost a year ago, but plenty of people are still feeling their impact. And the folks in Clarksville are still trying to make sure they have roofs over their heads.

Texaco has come to the assistance of its credit-card customers, recently mailing out 10,000 letters to Tennesseans offering help and, specifically, additional time to pay off their bills.

The aid package varies with each customer and situation, spokesman David Sandor

The extra time to pay "would be without penalty to the consumer," he said.

Texaco started the disaster help back in 1970, he said, and made the offer to 392,000 customers last year.

Freebie: What is a pension fund and what does it really mean to you?

If you're not sure, the federal Pension Benefit Guaranty Corp. can help.

You can get the booklet "A Predictable, Secure Pension for Life: Defined Benefit Pensions" by writing to the Consumer Information Center, Dept. 639E, Pueblo, Colo. 81009.

You can also go online at www.pbgc.gov

Candy McCampbell is personal finance editor of The Tennessean. Got questions about money matters? Send them to her at 1100 Broadway, Nashville, Tenn. 37203, by fax at 259-8093, or by e-mail at candymc@reporters.net and look for answers in this column each Monday.

LOAD-DATE: July 31, 2003

Evidentiary Exhibit Number 114

Chicago Tribune

March 5, 1999 Friday, CHICAGOLAND FINAL EDITION

SECTION: YOUR PLACE; Pg. 27; ZONE: C; Rental Q&A.

LENGTH: 932 words

HEADLINE: CONDO CONVERSION MAY MEAN HEAVE-HO

BYLINE: By Robert A. Boron. Special to the Tribune.

BODY:

Q--I rent an apartment in a Chicago high-rise apartment building. The building just announced it is converting to condominiums, and I have the opportunity to purchase the unit in which I reside at a discount. I have six months left on my one-year lease, and if I don't elect to purchase my unit, I have the right to live in the apartment until the end of the term while the developer tries to sell it.

If I decide not to purchase my unit, can I continue living in the unit on an extended or month-to-month basis? Can the developer force me to move out of the unit? What can happen if I decide to move from the unit before the lease runs out just to avoid a problem when the developer sells the unit?

A--You have a right under the city's condominium ordinance to purchase the unit, as that right has probably been explained to you by the developer. If you choose not to purchase your unit, you have the right to remain in the apartment for the term of your lease, but at this time, it does not appear that you have the right to remain in the unit for any longer period.

The developer cannot terminate your tenancy during the lease term. However, the developer also is not required to allow you to remain in your unit for any longer period, unless a longer period of time is dictated by condominium conversion statutes or ordinances. That is probably not the case in your situation.

Whether or not the developer has your unit sold when your lease ends has no bearing on your right to remain in the unit. If the developer has not sold your unit, he still has the right to refuse to renew your lease.

The election not to renew your lease is based upon a legitimate business decision, and is not based upon an illegal motive, such as discrimination or retaliation. A developer, as is the case with any landlord, has the right to refuse to renew your lease for a legitimate business reason. Further, if the developer has sold your unit, you clearly would not be entitled to remain in your unit.

The question becomes whether the developer plans on doing work within your unit prior to its sale to a purchaser.

In some situations, the developer will elect to refurbish a unit and then market it for sale. In that event, it is unlikely that the developer will allow you to remain in the unit beyond the lease term, because the developer would not want you to be using the new appliances or facilities that are being installed for the benefit of the eventual purchaser.

On the other hand, if the developer will not be refurbishing the unit until it is sold, the developer may allow you to rent on a month-to-month basis until the unit is sold, or must be made available for the work to be performed.

While you don't have a right to remain, depending upon the schedule of the developer, you might be able to negotiate a month-to-month deal.

It should be noted that you do not have a right to move from the property prior to the end of your lease, unless you and the developer agree to extinguish your obligations under the lease. The developer must honor your lease, and must allow you to remain for the balance of your lease term, regardless of the marketing of the unit. Similarly, you must honor your lease, and cannot move from the apartment before the end of your lease term, unless you and the developer agree otherwise.

Ultimately, the question will revolve around the sale of the unit. If the unit is sold quickly, or the developer envisions a quick sale of the unit, it is unlikely that you will be allowed to remain past the expiration date of your lease.

On the other hand, if the sales are not moving briskly, or if the developer doesn't envision having to rehab your apartment in the near future, the developer may be glad to get the additional revenue which your rent will generate while the building is being converted from rentals to condominiums.

Q--I moved into an apartment, and the landlord didn't require me to sign a lease. I didn't give a security deposit at that time. Now, four months later, the landlord is asking for a security deposit, even though I have been a good tenant. The landlord and I can't agree on the amount of the deposit. What are my options?

A--If you cannot come to an agreement as to the amount of the security deposit, and your oral rental agreement is nothing more than a month-to-month arrangement, you might have to move from the apartment. In the absence of an express agreement, you can pretty well assume that you rent on a month-to-month basis.

One of the downsides of a month-to-month rental is that the rental agreement can be altered on a monthly basis, and if there is not an agreement between the landlord and tenant, either party can end the leasing arrangement based on a 30-day notice. This is true with regard to security deposit issues, rent issues or any other issues pertaining to the tenancy.

For that reason, unless you are willing to relocate again, it may pay to compromise with regard to the security deposit issue. You might also consider agreeing to a greater security deposit in exchange for a written lease, which will provide you with more certainty and stability with regard to your right to remain in that apartment.

Robert A. Boron, a Chicago attorney who specializes in leasing matters, writes about landlord and tenant issues for the Tribune. Questions to him can be addressed to Rental Q&A, Your Place section, Chicago Tribune, 435 N. Michigan Ave., Chicago, Ill. 60611. He also can be reached by e-mail at rabltd@aol.com. Sorry, but he cannot make personal replies.

Renting.

LOAD-DATE: March 5, 1999

Evidentiary Exhibit Number 115

The Miami Herald
Found on Miami.com

The Miami Herald
February 21, 1999 Sunday FINAL EDITION
SECTION: TROPICAL HOME; Pg. 16H
LENGTH: 1193 words
HEADLINE: SECURITY DEPOSIT SHOULDN'T BE USED INSTEAD OF RENT
BYLINE: ROBERT BRUSS Herald Columnist
BODY:

Q.
Last October I rented my house to a tenant on a one-year lease. Recently he gave me notice he plans to move out the first of next month and wants to use his security deposit to pay his last month's rent. What recourse do I have to stop my tenant from doing this?
A.
Since your tenant didn't pay the current month's rent on time, your legal remedy is to begin eviction for nonpayment of rent. Unfortunately, by the time your case gets to court, the tenant will have enjoyed about a month of "free rent."

In most states, the tenant is responsible for rent under a lease until the property can be released to another tenant. To hold your tenant liable for unpaid rent, plus any damages, consult a local real estate attorney who specializes in evictions.
Q.
My husband and I have decided now is the right time to buy a home. Do you have a checklist for first-time buyers?
A.
Here are the four most important steps to take when buying a home:

* Price range. Before shopping for a home, shop for a mortgage. Get preapproved by the actual lender (not just prequalified, which means only "we think you can get a mortgage"). Then you'll know the home you can afford.

* Neighborhood. Inspect at least 10 homes in your price range in various neighborhoods throughout your town. Open houses are a great opportunity to quickly inspect many houses.

* School quality. Even if you don't have children, check the school quality where you are considering buying. Good schools help home value appreciation. Bad schools stifle market value appreciation, because middle-class families won't move into neighborhoods with bad schools.

* Physical condition. Armed with all this information, narrow your choice to a specific home in a specific neighborhood. Be sure to include in your purchase offer contingencies for mortgage financing (just in case the house doesn't appraise at your offer price) and your approval of a professional inspection report so you don't get stuck with a "lemon" house.

Q.
About four years ago, we subdivided our rural property into two parcels. Our property fronts on a county road. The parcel we sold off has a driveway easement over our land to reach the road. The buyer built a house on his land.

About six months, ago that property was sold to a developer who wants to subdivide it into five home sites. He has applied for approval and it looks as if he'll get it. But that means instead of just one owner driving over the easement on our land, now there will be five owners. Can we prohibit more than one owner driving over our easement?

A.
The answer depends on the wording of your easement. When you created the driveway easement over your land, you contemplated just one owner using it. However, if there was no prohibition against increased future use, the new owner might be within his rights to have five owners use your easement.

But there are court decisions allowing termination of easements for excessive use. Please consult a local real estate attorney to review the terms of your easement. I'm presuming there is no other access to the adjoining, landlocked parcel.

Now is the time to object to your new neighbor's subdivision plans. After he obtains subdivision approval, it might be too late to restrict use of the easement over your land.

Q.
We have owned our home for many years. If we sell it, our sale profit will be well over that new $500,000 exemption for a married couple. Is there any way to avoid paying tax on more than $500,000 of home sale profits?

A.
If you want to make an outright sale, the answer is no. Under the old "rollover residence replacement rule," it was possible to avoid tax by purchasing a replacement principal residence of equal or greater cost within 24 months before or after the sale. But IRC 1034 was repealed, except for binding sales contracts, as of Aug. 5, 1997. The "over 55 rule" $125,000 home sale tax exemption was also repealed as of that date.

The only way to avoid tax on more than $500,000 of home sale profits is to convert your home to rental status and then make a tax-deferred exchange under Internal Revenue Code 1031. You can then sell your rental house, have the sales proceeds held by a third-party intermediary, and use them to acquire another rental property of equal or greater cost. That might not be what you want to do. Please consult your tax advisor for details.

Q.
Our house is "upside down." We owe more on its mortgage than the house is worth. A real-estate friend says we can "walk away," because a mortgage foreclosure will stay on our credit file for only two years and then we can buy a more affordable home. What happens to a borrower's credit when you can no longer afford to pay the mortgage, and the house goes into foreclosure?

A.
Mortgage defaults stay on your credit report more than two years. Also, there is a question on mortgage loan applications asking if you have ever been involved in a foreclosure. However, a few lenders will make mortgage loans at high interest rates to borrowers who have been in foreclosure. Most will not. If you default on your mortgage, you will probably regret it. Federal Housing Administration and Veterans Administration lenders often pursue defaulting borrowers for deficiencies.

Rather than defaulting on your mortgage, I suggest you write to your lender, explaining why you cannot afford the mortgage payments. Perhaps a reduction in the mortgage interest rate can make your payments affordable.

Or ask the lender to approve a "short sale." That means you sell the house for its market value and the lender agrees to accept the sale price as full mortgage payment.

Rather than walking away and ruining your credit, try to work with the lender to salvage your credit. You can get out of this situation with dignity by doing what is right.

Q.

I am negotiating to buy a single-family house as a rental investment. Instead of renting it to a family, I am considering renting each of the three bedrooms to three unrelated individuals. Is this a good idea? If I do this, should I sign individual leases with each tenant?

A.

I do not recommend that you rent to three unrelated individuals unless you have experience doing so. Although you might be able to get higher rent than you would by renting to a family, you'll have nothing but headaches if one person moves out and the remaining residents can't afford the rent. Any landlord will tell you singles make the worst tenants. College students are even worse.

Another problem occurs if one of the residents doesn't get along with the others. The bad resident will drive out the good ones.

If you decide to rent to unrelated individuals, I suggest you sign a master lease with one tenant who is responsible for paying the full rent but can sublease to other tenants. Let that tenant be responsible for choosing his or her roommates. If you rent each bedroom to a tenant, since you're not living in the house, you'll have endless trouble.

Robert J. Bruss is a California lawyer and licensed real estate broker. Write to: Robert J. Bruss, The Herald, 1 Herald Plaza, Miami, FL 33132.

NOTES: BUYING AND SELLING

LOAD-DATE: October 28, 2002

Evidentiary Exhibit Number 116

Orlando Sentinel (Florida)
February 14, 1999 Sunday, METRO

SECTION: HOMES; Pg. J13
LENGTH: 714 words

HEADLINE: PUT TAX-BREAK SQUEEZE ON VACATION HOME

BYLINE: Robert Bruss

BODY:

Editor's note: This is the fourth story in a series about how to save real estate taxes.

Because vacation or second homes are neither principal residences nor investment properties, most owners don't realize the tax breaks they can get with careful tax planning. But careful documentation can result in annual tax savings as well as tax-free sales when such homes are sold.

The 1997 Tax Act was, at first, thought to have no effect on secondary residences. Until this new tax law, profitable sales of part-time homes were fully taxable. However, tax advisers are now showing their clients how to claim profitable tax-free sales.

To illustrate, suppose a husband and wife have owned their Arizona winter home for many years. They live there full-time for six months between November and April each year. Because prices have appreciated greatly since they purchased many years ago, they decide to sell for a $400,000 profit. Because they meet the "main home" ownership and occupancy test of new Internal Revenue Code 121 - having lived there an aggregate of at least 24 months over the past five years - the sale is tax-free up to $250,000 for each qualified seller.

Another example: Barbara and George live in their Houston home November through April and reside in their Maine home May through October. If they sell either home, it can meet their "main home" requirements, because they have owned and occupied each for at least 24 months within the 60 months before the sale. They can claim up to $500,000 tax-free home-sale profits.

To qualify for this major tax break of the 1997 Tax Act, smart owners of vacation or second homes keep careful records to prove they meet "main home" occupancy standards during the months in which they live in these homes. Evidence includes utility bills, voter and automobile registration and business or retirement income.

Most secondary residences are not great tax shelters during ownership. However, there are four areas of potential income tax savings:

Minimal or no rental time. If you rent your vacation or second home to paying guests less than 14 days per year, regardless of the rent amount received, you don't have to tell Uncle Sam about that rent income. It's tax-free.

In this personal use category, you can deduct the mortgage interest, property taxes, and any uninsured casualty loss (such as rain damage) on Schedule A of your income tax returns.

No personal use time. If your secondary home is rented or available for rent all the year, and you never occupy it except for minimal cleaning and repair time, all the rental income and expenses are reported on Schedule E of your income tax returns. Mortgage interest, property taxes, insurance, utilities, repairs and depreciation are subtracted from the rental income received.

In this category, you'll probably have a loss. If you earned less than $100,000 adjusted gross income in 1998 and "materially participated" in managing your second home, up to $25,000 "passive loss" expense from this rental activity can be deducted against your ordinary taxable income.

Annual personal use is fewer than 15 days or 10 percent of the rental days, which exceed 15 per year. If you use your vacation or second home minimally in this category, there is no limit on your loss deductions, subject to the $25,000 annual "passive loss" limit. However, the profit motive rule of Internal Revenue Code 183 applies, requiring a profit at least three out of five years of your rental activities.

Annual personal use exceeds 15 days or 10 percent of the rental days, which exceed 15 per year. With heavy personal or family use of your vacation or second home in this category, you can't deduct any secondary home loss on your home tax returns. Income and expenses must be reported on Schedule E. However, any resulting loss cannot shelter your ordinary income from taxes.

The correct order for deducting expenses is mortgage interest, property taxes, uninsured casualty losses, operating expenses and depreciation. If interest, taxes and uninsured casualty losses exceed the rental income, these excess expenses can be deducted as itemized deductions on Schedule A because these expenses are always deductible.

Next week: Tax deductions for your residential moving costs.

COLUMN: Realty tax tips

LOAD-DATE: February 14, 1999

Evidentiary Exhibit Number 117

Orlando Sentinel (Florida)
February 14, 1999 Sunday, METRO

SECTION: HOMES; Pg. J1
LENGTH: 1126 words

HEADLINE: REALITY AND YOUR RETIREMENT DREAM;
DON'T ACCEPT THE HAPPILY-EVER-AFTER PROMISES OF A SALESPERSON. ASK QUESTIONS AND GET THE FACTS.
BYLINE: Kerry Smith
BODY:

The buzzwords vary between retirement communities but not by much. Most are "pristine" and "convenient to the city," and they promise to "make your retirement years golden." Many older adults, worried about the change from career to retirement, want to believe the message. They want the retirement years to be happy and fulfilling. Why else call them "golden"?

First, a small dose of reality: Retirement communities are businesses. They exist to make a profit. The community owner, usually a corporation, may care about the health and well-being of its residents. Or it may not. The community may have developed amenities that give residents a diversified choice of activities. Or it may have developed just enough to look good in a brochure.

Second, a small dose of philosophy: No corporation or individual can package and sell a quality retirement. A quality retirement - defined as happy and constructive post-career living - comes from within. By offering a golf course, a swimming pool, travel arrangements or volunteer opportunities, an adult community may provide the raw ingredients for success, but the ingredients are only as good as the retiree who uses them.

Central Florida has diverse communities with different styles of management. Some communities believe that their financial success comes from their residents' happiness. Others may be concerned more with current sales than current residents. Finding the right community requires insight, research and a handful of well-worded questions asked of the right people.

Keep these tips in mind when shopping:

Document all promises. A contract is a legally binding document. The sales contract is the only agreement that counts and the only place where promises must be kept. Salespeople can stretch the truth, communities may be sold and future development plans may change at any time. If buyers do not protect their rights in the contract, they do not protect their rights at all.

Pay attention to construction details. How many nails per square foot will hold down the roof? What type of pipes will be installed? Can you reach wires and telephone lines if, in the future, you choose to make changes? If unexpected problems arise, what recourse do you have? Each home is a unique project and even a top-of-the-line builder can make an occasional mistake. Consider hiring an inspector to guarantee building standards.

Listen judiciously. Salespeople sell. That's their job. While they sell homes, retirement salespeople promote the golden lifestyle. General promises of security, maintenance-free living and multiple social events may be true but might not be as dynamic as the salesperson claims. Grass may be mowed, but who pulls weeds? Social

events may be planned, but what type? Intentional lies may amount to fraud, but creative property descriptions are simply good salesmanship. Jack and Patricia McCurdy did extensive research before having a house built in a retirement community in Lake County. One tip the McCurdys share is to be wary of "host couples."

"Some communities take shoppers to dinner with a couple already living in the community," Jack McCurdy says. "This couple gets a free dinner and, if the salesperson sells you a house, an extra hundred bucks. Of course, the salesperson only invites couples deliciously happy with the place, and every community has at least a few of those."

Also be wary of community size descriptions. A development with brisk sales wants to keep those sales going and has a financial incentive to buy more land for expansion. That fact probably won't come out during a sales presentation, however, especially if the land purchase is only tentative. If shoppers know that a new section debuts in four months, they have less incentive to buy a lot in an existing neighborhood.

Look to the future. What is the potential rent or activity fee increase per year? An addendum: Who decides how much the payment will increase?

Hal and Dee Hillman moved to a Central Florida manufactured-home retirement community in 1993 where they owned their home but rented a lot. Their lease agreement stated that rent could go up no more than 5 percent per year, but the contract did not specify a measure, such as inflation, for the increases. Their rent increased the maximum amount each year.

Last year the Hillmans moved to Spruce Creek Country Club, Del Webb Corp.'s site-built community in south Marion County near Lady Lake. They're happy with Spruce Creek, but they have not yet sold their previous home. A buyer would have to accept the Hillmans' lease contract, and the Hillmans are competing with lower lot rents that the developer now offers to new residents.

"They're trying to sell new homes," says Hal Hillman, "so they make sweetheart [lot rental) deals below what I'm paying. Some new residents pay $240 per month, guaranteed for 10 years, while I'm paying $300 per month after living there for five years."

Find out who owns what and is responsible for maintenance. Who owns the utilities? Who pays for repairs? A few communities advertise that roads, streetlights and-or utilities are city-owned, meaning that local government must make all repairs and upgrades. Communities that own their own utilities and roads usually have a contract clause stipulating that major expenses will be shared by all homeowners. Make sure you understand any financial requirements above and beyond the monthly activity fees charged.

Take your time. "Take at least 60 to 90 days to get a hard look at the community," says Hal Hillman. "At Spruce Creek [Country Club), you can live in a guest villa for a week for a nominal fee. You can play our golf course. You can look at what's going on in the community center. [My first community) made every effort to keep home shoppers away from residents. If a street had a lot of for-sale signs, the salespeople avoided it like the plague."

Talk to people with objective opinions. Most residents want to talk about their community, the good and the bad. If you have a hobby, find out if there's a local group, contact members, explain your interest, then ask about the community. Also, always ask the salesperson for a roster of the residents who serve on the homeowners' board, then contact two or three. If golf membership is administered separately, check with residents who serve on the club's advisory board.

Don't expect perfection. "You can't go into any development and have everything 110 percent right," says Hillman.

When you look past the "golden lifestyle" offered, a retirement community is a product that provides shelter, potential friendships and a list of social activities. A realistic attitude coupled with research is the best defense against a buying mistake.

COLUMN: Retirement living

LOAD-DATE: February 16, 1999

Evidentiary Exhibit Number 118

SAINT PAUL PIONEER PRESS
February 6, 1999, Saturday

KR-ACC-NO: SP-REALTY-QNA
LENGTH: 3041 words
BYLINE: By George Karvel
BODY:

Q. I am a divorced mom, age 43. I have a quit -- claim deed to my house from my ex-husband, and I have been making the monthly mortgage payments of $ 377 by myself since 1981. I am looking forward to the payoff in January 2004. The current balance of the mortgage is $ 13,000, and the interest rate is 8.1 percent. I hear about the interest rates falling recently and I wonder, "Should I refinance?" I definitely don't want to extend the length of my loan, but a lower monthly payment or a quicker payoff would certainly be attractive. Would the cash outlay for inspections and closing costs make refinancing a bad idea?

-- Connie Parmer

Auburndale, FL 33823

A. Dear Ms. Parmer:

You are asking the correct questions. Just because mortgage interest rates are falling doesn't mean that it is financially wise to refinance. The cost of appraisal, origination fees and other closing costs would be more than any savings from a reduced interest rate.

Q. For what purposes and by whom can the land designated as the easement be used. I can understand using the area for services, such as buried water, sewer, gas, side walks fire protection and electrical lines. Can an individual arbitrarily place their basketball goal or personal mailbox in the easement area common to someone else's property without permission because they do not wish to have the same items in the easement area common to their property?

-- Erwin Johannes

Covington, IN 47932

A. Dear Mr. Johannes:

The landowner who gives an easement retains all rights of use not inconsistent with the easement. Basketball backboards with poles or mailboxes cannot be placed on another's property without permission.

I have seen many cases, however, where adjoining landowners have stored RVs, planted gardens and even built fences in an electric utility easement where the underlying fee is owned by a railroad. As long as the easement holder or fee owner does not object, nothing can be done by those who do not own the land. Of course, you could call the fee owner and report the trespass.

Q. The balance on our mortgage is at present $ 30,726.63. Our payments are $ 356.21 prin. & int. The interest rate is a fixed 8.00 percent. The original was 15 years and we now have 10yrs 9months left on the terms. We would like to pay the note in half the time. How much extra do we pay on the principle per month to achieve this?

-- Mace Vallejo

A. Dear. Mr. Vallejo:

To pay off your remaining mortgage in 5 years you will need to pay $ 623.04 each month. For a 6 year payoff, the required payment will be $ 538.76.

The easiest method for determining the payment necessary to retire a loan in a certain time period is to contact a bank loan officer. They can make the calculation quickly and without any charge for their services.

Q. My neighbor who is planning to sell her home next year, has talked to two different realtors about the value. (She has not listed it and will not until spring or summer.)

They both have impressed upon her that a modular home is not to be compared in value to a house built on the site.

My main interest is whether there is such a great difference in value between the modular & a conventional house.

-- Jacquelyn L. Japp

Lakebay, VA

A. Dear Mrs. Japp:

There may be a significant difference in the value of a modular home as compared to a traditionally constructed home. There are instances, however, when a well- built modular home will be priced the same as a conventionally constructed home.

Design, construction materials, foundation and other housing features determine value. Suggest that your neighbor obtain an independent fee appraisal. The cost would be $ 250-$ 400.

Alternatively, contact local real estate agents for a free market valuation. After talking to 3 or 4 real estate agents, a fair price can be set. Also, everyone will know how this home's modular construction has affected its value.

Q. My question has to do with capital gains tax.

In 1955 my wife and I purchased two building lots. Each one acre in size each cost $ 1,200. We built a home on one of the lots.

In 1992 my wife and I were divorced, as part of the property settlement agreement, she received the home and I received the building lot. I recently sold the lot.

An attorney friend has told me the capital gains tax would be figured on the value of the lot when I became sole owner in 1992, but an H & R Block tax person tells me it is figured on the price paid for the lot in 1955. Your opinion please?

-- James R. Hein

Hellertown, PA

A. Dear Mr. Hein:

Great idea but...

Your attorney friend should stick to practicing law and let the tax practitioners practice tax. To my knowledge, you do not receive a "step-up" in a property's basis because of a divorce settlement. Your capital gains tax will be determined using the 1955 cost of the lot.

Think about it, if divorce resulted in a n increase in basis reducing taxes due from the sale of real estate or other capital assets, any couple facing substantial capital gains would get divorced. They, of course, could remarry after they sold their assets and avoided taxes.

Q. My husband and I own two homes. One of our homes we live in and the other one my mother lives in and pays the mortgage. Last year instead of having to claim rent there, (which we weren't actually receiving as she was paying the mortgage only) at her house, we decided to refinance her house and put her on as part owner of the house so we wouldn't have to claim rent on our taxes.

Here is my question -- By putting her name on the mortgage as a partial owner, in the event of her death would any other family member (brother & sisters) have any legal ownership of her part of the house?

Or, since my husband and I both are listed on the paperwork as part owners, if this would alleviate the worry of any one else being able to claim our property?

I just want to make sure that my brothers and sisters have no legal claim to our house since they have not participated in any bill paying, mortgage paying, etc... even though my mother's name is on the property with ours.

-- Kelly R. Hall

Greenfield, IN

A. Dear Ms. Hall:

When someone signs a mortgage promising to repay a loan with interest, they do not receive any ownership interest. All they have is responsibility to repay the loan.

Ownership is represented by a deed. If your mother's name is on the deed, then her ownership interest becomes part of her estate. Her estate, upon her death, will be distributed according to her will. In the absence of a will, her property is distributed according to your state laws of intestate succession.

To solve your problem, you need the guidance of your attorney. For your peace of mind, the money will be well spent. See your attorney soon before you have a mess that is even more costly to correct.

Q. Hope you can help us.

A brief history:

In 1984 my wife and I bought a home through the VA.

In 1990, because the mortgage payments were increasing all the time, we decided to relocate to another area. We resold the home under a VA Program called "Assumption" In our case the new owner paid the monthly payments directly to the lender bank.

Now, we are getting loan default notices from a collection agency.

It has been established that the previous owner left the area without notice, presumably to Mexico -- her boyfriend had bought it for her.

We now live in an apartment and pay affordable rent. We are very happy in our present situation. We exist on a small retirement check and my wife gets minimum wage at her job. We've been 8 years in our new location.

This caught us by surprise. We can't handle anything like this.

A. Dear Mr. Miguel,

A borrower's obligation to repay their mortgage does not cease until the loan has been repaid in full. Sellers who permit buyers to assume their mortgage mistakenly believe they have no further obligation. Nothing is further from the truth.

When a buyer "assumes a mortgage, or buys property "subject to" the existing mortgage, the seller will retain a primary or secondary liability for the debt. In the event the buyer discontinues making the monthly payment, the lender may seek payment from the original borrower. In the event of foreclosure, the original borrower will have liability for any deficiency.

When a mortgage is assumed, the lender must provide and sign a novation contract to end any further liability on the part of the original borrower. In other words, without a release by the lender from further obligation for the debt, a home seller/original borrower continues to have a financial obligation in the event of default by the buyer.

Q. Four 1/2 years ago my ex-wife and I purchased a home for $ 54,500 and got a second mortgage for $ 9,000 to improve. We divorced in 1996 and she signed a quit claim deed. Since I've remarried and I'm self-employed for 3 years. My taxes show $ 8,000 to $ 12,000 a year profit. I would like to refinance at a lower rate. Now, I have 9 percent interest. My home is appraised at $ 65,000. I owe $ 15,000 first and $ 9,000 second. What kind of profit do I have to show to refinance? I earn $ 35,000 a year.

-- Ben

Augusta, GA

A. Dear Mr. Shirely:

With regular employment and good credit, an income of $ 35,000 per year will be sufficient to support a mortgage loan at 7 percent interest, for 30 years, in the amount of approximately $ 112,000. To find out specifically the cost, closing fees and size of mortgage loan for which you are qualified, go to a local bank or mortgage broker and talk to a mortgage loan officer. They will discuss their loan products and pre-qualify you without charge.

With a home value of $ 65,000 and a 95 percent loan, you would be able to borrow enough to pay off the existing loans and lower your monthly payment.

Q. I believe I read somewhere that you cannot be charged a pre-payment penalty if your house has gone into foreclosure and you are now paying off the loan. I live in Indiana and I'm wondering if this applies to my state, if it's a federal regulation or whatever. What do you look for on your mortgage papers to find out if this is so. I would appreciate any information anyone would have on this subject.

-- Eviev43

A. The standard mortgage form contains what is called an Acceleration clause. This clause specifies that, if the borrower fails to make their payment, thereby defaulting on their promise to pay, the entire debt will become due and collectible.

Foreclosure only occurs a last resort after failure to make the agreed monthly payments. Consequently the entire mortgage becomes due and payable. After foreclosure borrowers are allowed period of time in which to pay the entire debt to avoid the loss of their home. This is called a redemption period which varies from state to state. If the mortgage loan is paid (redeemed) there are no prepayment penalties.

Q. Last year, me and my husband got divorced. The divorce settlement I gave him the house we lived in together since I was told there was no equity in it at the time. The only paper I signed was the divorce paper. Is that enough to transfer ownership to him and can I get anything should he decide to sell it late?

-- K. Devonshire

Martinsburg, WV

A. Dear Ms. Devonshire:

A divorce decree is meant to be a final property settlement. Unless fraud can be established, expect to be bound by the terms of the decree.

Your concerns, legal rights and verification of my answer should be discussed with your attorney.

Q. My mother 'deed gifted' her triplex to my sister and myself in 1977 and she had lifetime occupancy and income until her death in 1987. The cost basis of the property in 1977 was $ 75,000. When we inherited it in 1987 the value was $ 375,000 and we just had it appraised and the current value is $ 500,000.

We would like to sell it and wondered what the best procedure would be to save on the inheritance tax. Should we make it our principal residence for two years or if each of us, my sister and myself, bought like kind rentals would that shelter the tax?

-- Mary A. McLeod

San Anselmo, CA

A. Dear Ms. McLeod:

Based on the information and dates provided, there would be no inheritance taxes resulting from the sale of you triplex. As a rental property, sale would result in capital gains tax.

To avoid taxes, if the triplex were converted from rental to primary personal residence, after two years up to $ 500,000 of gain for a married couple ($ 250,000 if single) may be excluded from taxation. Keep in mind, if you occupy only one of the three rental units, only that part of the sale price allocated to the occupied unit is eligible for tax exemption.

Alternatively, the triplex could be part of a tax free exchange for other rental property. To pursue a tax free exchange, you will need the services of a knowledgeable real estate broker and counsel of an attorney.

Q. Regarding your response to the questioner about making bi-monthly and automatic debits, your response to take out a standard mortgage with 12 monthly payments and at the end of each year sending an extra payment ignores two primary benefits of bi-monthly and automatic debits, namely, tremendously reducing the amount of interest paid on the principal and accelerating the equity in the property.

-- Carl L. Wright

Tipton, IN

A. Dear Mr. Wright:

An extra monthly payment at year end has approximately the interest saving advantages as 26 bimonthly payment plans. Additionally, a voluntary additional monthly payment at year end does not require the borrower to pay any extra administrative fees or interest rate premium, or both. Further, in the event a borrower has financial difficulty, an additional year-end payment is optional, bimonthly payment plans, once established are mandatory.

It makes no sense to pay someone for a bimonthly mortgage payment plan when an individual can achieve a similar result for free.

Q. My husband and I made an offer on a house in James City County, Virginia. The house listed at $ 265,000 and the negotiated price was $ 245,000. The Sellers provided us with a Disclaimer, gave us the right to have a professional inspection, and also acknowledged through the agreement that they were to repair all broken window seals and floor tiles.

The inspection found water penetration and erosion at one corner of the crawlspace, moisture damage to fascia board, soffit, siding and sheathing, and an inoperable cooling system. In addition, the inspector noted that the house had a gravel footing foundation, balloon-framing of treated lumber that is very unusual in this area. He also noted that the living room floor flexes.

Based on the negative inspection results, we decided to rescind our offer by invoking an addendum in the purchase agreement which stipulates that: "If Purchaser disapproves of property condition or Seller refuses to cure the noted defects, in a workmanlike manner, the referenced contract may be declared null and void by Purchaser, a release of contract shall be executed by all Parties and Purchaser's deposit refunded. This addendum shall not apply to cosmetic defects or supercede any provision stated in the contract."

We signed a purchase agreement release form with a statement that the $ 1,000 deposit shall be refunded to the Buyer. We also told our agent that after the Sellers signed the release of the present contract, we would like to make a new offer for $ 180,000 and assume all repair costs and liabilities. The Sellers made a counter offer of $ 238,000. We replied that $ 200,000 was our limit. These offer and counter offer were all verbal through the agents.

The Seller signed the release but demanded that they keep the $ 1,000. Our agent's broker then sent a letter to the Seller stating that the deposit would be returned to the Buyer unless a protest letter was received within 30 days of receipt of the broker's letter. The Seller protested by contending that we knew about the defects prior to the inspection, that the defects uncovered by the inspector were cosmetic, and that we were attempting to use the inspection results to negotiate the price down.

We did not know about any of the water damages (some were hidden). We noticed the broken seals during our touring of the house but assumed that they were manufacturing defects. We also assumed that dropping accidents caused the broken floor tiles, and never noticed that the floor flexes. A disturbing fact is that on the day of the inspection, our agent told us that the Sellers knew about the water damage. Is it legal for the Sellers to use a Disclaimer statement if they knew about the moisture problem?

The Broker advised us to go to a small claims court to settle this matter by a judge. A clerk at the James City County court told us that we could not use a warrant in debt for this claim and needed a lawyer to handle the matter. One attorney told us over the telephone that he has no time to handle small claims. We have two questions: (1) Are the defects reported by the inspector cosmetic? (2) After we found out all the defects, do we have a right revise our offering price downward?

-- John-Paul & Sylvia Lynn

Suffolk, VA

A. Dear John-Paul & Sylvia:

When a deposit or earnest money is included with a purchase agreement, the broker does not give the deposit to the seller. Good practice, as well as most state license laws, requires the broker to deposit earnest money into a trust account.

Check your state statutes with regard to a broker's duty to use and maintain trust or escrow accounts. When the seller signed the purchase agreement release, the broker should have returned you deposit.

Although you are angry, the cost of litigating the issue of "cosmetic defects" is likely to be more than your deposit. If you insist on filing a suit, I'm sure you can find an attorney to represent you. If I am correct regarding your broker's obligation to place your deposit in a trust account, the better course of action is against the broker.

JOURNAL-CODE: SP
LOAD-DATE: February 19, 1999

Evidentiary Exhibit Number 119

Chicago Tribune

January 30, 1999 Saturday, WEST COOK SPORTS FINAL EDITION

SECTION: NEW HOMES; Pg. 10; ZONE: W; Realty Q&A.

LENGTH: 1748 words

HEADLINE: NO BARGAIN;
THINK TWICE BEFORE BUYING THAT YEAR-ROUND HOUSE IN A DISTANT VACATION AREA

BYLINE: By Robert J. Bruss, Tribune Media Services.

BODY:

Q-- My partner and I are first-time buyers considering a home purchase in a vacation area. What are the special considerations we need to be aware of in a secondary market? We know that over half of the homes in the area are second homes. But this would be our primary residence. We love the area, especially because it is so much more reasonable than urban areas. What is the potential downside of this choice?

A--A frequent problem of buying a year-round home in a vacation area is lack of buyer demand. Second or vacation homes are luxuries, not necessities, so low buyer demand quickly reflects in lower resale prices. Also, mortgage financing periodically dries up if economic conditions are not good. A recession will obviously hurt the resale value of a home in a vacation area when there are few buyers.

Since you are contemplating buying in a semirural area, be sure to check the water and sewer situation in addition to having the customary professional home inspections. If the home you are considering has its own well and/or septic system, these can provide unexpected problems. Make your purchase offer contingent on satisfactory testing.

If you decide to buy, do so during the off-season to get the best bargain price. Vacation areas usually have considerable seasonal market value fluctuations, so avoid buying during the high season. Don't be in a hurry to purchase, as you can often find incredible bargains from motivated absentee sellers. Of course, make your purchase offer contingent upon obtaining the specific mortgage you need. To minimize your financial risk, get the maximum mortgage you can afford.

Q--I was preparing to make a purchase offer on a new house in a new subdivision. Then I was informed there would be a "lot premium" for a better lot. Is this something new? How can I get out of paying this fee?

A--Many developers add a "lot premium" for the lots that are considered most desirable, such as those that are larger or have a view. Before paying a lot premium, ask yourself if the extra cost is worthwhile. Be especially wary of paying a premium for a corner lot. Many home buyers think corner lots are worse, not better, because there is traffic on two streets. The presumed (but often erroneous) corner lot advantage is having only two adjoining neighbors instead of three.

Q--We offered to buy a semirural house that the realty agent said was on a one-acre lot. Our offer, which contained an inspection contingency, was accepted. When our professional inspector checked the house, I asked her opinion of the best spot to build a new swimming pool. Since the lot boundary was unclear, she suggested getting a survey, which we did. The survey shows the lot is substantially less than one acre. Also, there is no suitable place to put a pool because of the lot boundaries.

We notified the seller, through our agent, to cancel the sale for misrepresentation of the lot size. But the seller refuses to refund our $5,000 deposit because the listing said "one-acre MOL," which apparently means "more or less." How can we get our deposit back?

A--Congratulations on carefully investigating before, rather than after, purchasing that home. Since you apparently disapproved the inspection of the property because the lot size is less than represented, you clearly are entitled to cancel the sale and get your $5,000 refunded. If necessary, take the seller to court. But a strong letter from your attorney to the seller and the realty agents involved (who would also be named in the lawsuit) will probably bring the desired deposit refund.

Q--I am considering buying a condo in a brand-new complex of only 12 units. So far, only six have been sold in the four months since the building was completed. The units are townhouses. The drawback seems to be that it's on a busy corner with tiny open space. Do you think I should buy here?

A--I can't advise on the desirability of a specific condo purchase. However, I am concerned that only six out of 12 condos have sold in four months, which indicates the condos may be overpriced. Another possible problem is the small number of units to share maintenance costs. Still another drawback is that most mortgage lenders won't close their loans on condo sales until at least 75 or 80 percent of the units are sold.

Q--I am a real estate paralegal, currently studying for my real estate license exam. I am a veteran, but my past credit history isn't so good. However, on my last Equifax credit report, I had only eight collections and one tax lien, which I am trying to pay off so I can buy a house. Will I have any trouble obtaining a VA mortgage?

A--Although VA loan qualifications are often easier than conventional lenders' qualifications, eight collections and a tax lien will probably disqualify you for approval until they are cleared up. Another problem is your planned change of jobs. Until you have a success record as a real estate salesman (usually two years of consistent earnings), you will have trouble obtaining any mortgage. I suggest you consult a VA mortgage lender to have your financial situation reviewed.

My recommendation is that you postpone buying a home until you straighten out your finances and are earning a steady income in your new real estate sales career. While you're waiting, a lease-option can give you the opportunity to try out a home for a year or two before purchase while you build a rent credit toward the down payment.

Q--About 15 years ago, a favorite aunt and uncle with no children asked to add me to the title of their home as a joint tenant. I didn't like the idea, but they pleaded with me. I relented and assumed responsibility for the property taxes. Several years later, a minister entered their lives and demanded I remove myself from the title. I soon stopped receiving the property tax bills.

On inquiry of the local tax collector, I learned my aunt and uncle had created a family trust with the minister in charge (they gave him power of attorney). I was somehow removed from the title. But the tax collector reinstated my name to the title and tax bill. Can the house be put into a family trust without my consent and signature? What should I do?

A--Run, don't walk, to the best real estate attorney in town. If your aunt and uncle executed a deed from themselves to you and them as joint tenants with right of survivorship, your name cannot be legally removed from the title without your written consent. Perhaps your signature was forged. However, your aunt and uncle could put their interest in the property into a family trust without your consent.

Whatever happened, it's time to make sure that minister isn't taking advantage of your relatives. A quiet title lawsuit might be needed to sort things out.

Q--In October, I sold my rental property to the school district for $282,000. I hope to purchase another property for $95,000. Can I get a tax break even though I didn't put the sales proceeds into escrow?

A--Please consult your tax adviser. If the school district condemned your property under eminent domain, Internal Revenue Code 1033 gives you at least two years to reinvest the sale proceeds into a similar use property without owing tax on your profit. However, if you made an outright sale to the school district and didn't comply with the Starker tax-deferred exchange rules of Internal Revenue Code 1031(a)(3), then you owe tax on your profit even if you reinvest the proceeds into another rental property.

Q--I own a one-third share of a property, which I want to sell. I have asked the two other owners if they are interested in buying my share. If they don't buy me out, what are my options?

A--Presuming you hold a one-third interest in the property as a tenant in common, you are free to sell your share to whomever wants to buy from you. However, there isn't much demand for one-third of a property. If your co-owners elect not to buy you out, you could bring a partition lawsuit to force a sale. The judge then decides if the property should be sold and the proceeds divided among the owners. Please consult a real estate attorney in the state where the property is located for full details.

Q--I enjoyed your recent article about Starker delayed cross-country tax-deferred exchanges. The property I want to exchange is a fourplex where I've been living in one apartment since I retired in 1993. Can I make a tax-deferred exchange of this property to avoid tax on my sale profit?

A--Yes. For income tax purposes, you will be selling two properties. One is the value of your personal residence apartment. The new Internal Revenue Code 121 $250,000/$500,000 tax exemption applies to that "sale," which should shelter all or most of your profit from that unit. The second "sale" is the value of the three rental apartments.

Internal Revenue Code 1031(a)(3), the Starker exchange law, applies to defer tax from the profitable sale of these units. You'll need to have the proceeds held beyond your constructive receipt by a third-party intermediary, such as a bank trust department, to use to buy the replacement investment or business property. After the sale, you have only 45 days to designate the replacement property and 180 days to complete the acquisition with the sales proceeds from the three rental apartments.

Q--Our home is paid for. We would appreciate information on the pros and cons of giving our oldest son, who is executor of our will, a quick claim deed. Is this a good idea?

A--If you have a considerable profit in your home, giving your son a quitclaim (not quick claim) deed before you both die means he would take over your low cost basis for the house. When he eventually sells it, he will have a substantial profit.

Presuming your goal is to avoid probate costs and delays, a living trust would accomplish that result at low cost. A living trust can spell out your wishes for the house and other major assets, such as bank accounts, after you both die. Until then, you can manage your assets normally. I see no advantage, but lots of disadvantages, of deeding your house to your son before you die. Please consult a local estate planning attorney to create a living trust to avoid probate yet retain control.

PLEASE NOTE: Real estate laws vary from place to place. Be sure to check the laws of your state and municipality before making decisions on real estate matters.

Write to Robert Bruss at Tribune Media Services, 435 N. Michigan Ave., Chicago, Ill. 60611.

LOAD-DATE: January 30, 1999

Evidentiary Exhibit Number 120

Business Dateline;

Business Journal-Portland

January 29, 1999

SECTION: Vol 15; No 49; pg 1

LENGTH: 1763 words

HEADLINE: Affordable housing crisis response slams developers

BYLINE: Brian K Miller

DATELINE: Portland; OR; US; Pacific

BODY:

Eighteen years ago, Portland developer John Beardsley signed an agreement with the federal department of Housing and Urban Development to provide low-income housing in Portland for 20 years.

Beardsley is holding up his end of the bargain, and HUD, at least in Beardsley's case, is doing the same. Now, however, as the contract nears expiration, the city of Portland is trying to prevent Beardsley and others from realizing the agreement's net benefit: the ability to convert units to market-rate rents when contracts expire.

In August, at the urging of then-housing commissioner Gretchen Kafoury the Portland City Council passed an ordinance that forces owners to do one of three things: keep the buildings affordable in perpetuity; sell them to the city; or pay a "replacement fee" of no less than than $ 31,000 for each lowincome apartment unit they convert to market rate.

The upshot for developers like Beardsley is that, instead of a payoff at the end of their affordable h0using projects, they're getting the shaft.

(Photograph Omitted)

Captioned as: John Beardsley and his 39-unit Western Rooms Building have gone through the city's ringer.

They say the city changed the rules of the game while the game was well underway, effectively killing the payoff they were told awaited them at the end of their contracts.

Many of Portland's for-profit owners of low-income housing describe the ordinance as morally and legally indefensible. They say they're planning to sue. Others say they'll sell their buildings to the city and wash their hands of the mess.

Owners say that HUD's housing program, generally called the project-based Section 8 program, was never the "winwin" venture it was touted to be when the state and HUD badly needed housing and developers badly needed loans for development. HUD provided the loans, and developers either converted existing buildings or built new ones to house the poor. Builders were, in theory, afforded substantial protections against losses as a reward for their willingness to step up to the affordable housing plate.

In fact, many of the owners say they have either barely broken even or lost money, despite a few well-publicized cases to the contrary Adding insult to injury, they say, contract extensions are now available in only one-year increments at reduced subsidies, making the program even less appealing.

Beardsley, however, is stuck.

He doesn't want to sell. Since going $ 1.3 million into debt-half of that at 13 percent interest-to rehab his building for the HUD program, he has purchased the buildings on either side and hopes to acquire the entire block for a future business opportunity

And he certainly doesn't want to keep the building subsidized. Contract extensions with HUD are tenuous at best, and any assistance from the city means a 60year commitment to serve Portland's lowincome population. But if he does neither he's subject to the replacement fee. In the case of Beardsley's 39-unit Western Rooms Building, that amounts to a $ 1.2 million payment-more than the assessed value of his entire property. His only hope appears to be that litigation will overturn the ordinance.

"The city has taken the position that somehow (it is) party to this contract," Beardsley said. "It's not unlike the city telling all city residents with governmentbacked home loans that a room in their house shall be made available to the city's low-income population.

"It's socialistic, confiscatory, unconstitutional and illegal, and those are just the words I can use openly over the phone," he said.

Kafoury who did not run for re-election last fall, said in an interview late last year she regrets the direction the housing squabble has taken.

"I wish it wasn't this way," she said. "I wish we didn't have to kind of hold the club. But circumstances have changed dramatically We are in a crisis, and I'm one of those people who is going to fall on the side of the very low income."

The city council is trying to stem the relentless attrition of Portland's lowincome housing units. The count of affordable units has dropped from 5,138 to 3,832 over the past 20 years, while the need has moved in the opposite direction. The city's Preservation Task Force said in a report that an estimated 2,400 more units of lowincome housing in 50 properties are at risk of being lost in the next several years as HUD contracts expire.

The alarm was initially sounded in mid1997 when Hans Juhr, a for-profit owner of affordable housing who had fulfilled his contract, opted out of the HUD program and sold his 56-unit Roosevelt Apartments to a condominium developer. As a result, the building's primarily elderly and disabled population was forced to relocate. The media gave prominent coverage to the plight of those essentially evicted from their homes, coverage which helped elevate the situation to crisis status.

Kafoury reacted by negotiating for the city's purchase of 333 Oak, another HUDsubsidized, lowincome building that Juhr owned and wanted to unload. Kafoury decried Juhr's negotiating tactics. But he ultimately sold to the city for $ 3.8 million despite receiving higher bids from the private sector

Kafoury then pushed through council the Housing Preservation Ordinance. The controversial legislation gives the city right of first refusal to purchase project-based Section 8 projects when the owners either decide to sell or opt out of the program after their contracts expire.

Low-income housing advocates consider Kafoury a hero. They say she did what neither Congress nor HUD could do: preserve affordable housing in a city with a tight housing market . The city is even naming a low-income housing project at Southwest 13th Avenue and Columbia Street after Kafoury

Portland's for-profit developers of affordable housing have a different view of her. Some say she was a lame-duck liberal looking for a legacy at their expense. She changed the rules of the game in midgame, at a time when they were all anticipating a very different outcome.

To make it worse, the owners were labeled villains both by Kafoury and in the written materials supporting the ordinance.

"Fifty-three percent of all HUD projectbased Section 8 contracts (excluding those owned by nonprofits and CDCs) receive subsidized rents above-fair-market value; some as high as 246 percent of the fairmarket rent," said one finding. Said Kafoury, "They took virtually no risk, put in no equity and got a very sweet deal, in my opinion."

Harold Schnitzer is the developer and owner of low-income housing who Kafoury said was the basis for the "246 percent" reference. He believes Kafoury and the ordinance are simply furthering serious misconceptions about the affordable housing program.

"What (Kafoury) doesn't seem to want to understand is that, when these projects were built, interest rates were at all-time highs, running up to 19 to 20 percent per year," Schnitzer said. "We managed to get 13.5 percent and it was considered to be a good rate at the time Therefore, the mortgage payments on these projects would be twice as high as the bonds that were put out a couple of years prior to that time at 6.5 percent.

"As a result, when HUD and the state computed the rent necessary to cover the debt service, the rent obviously had to be higher But there was no additional profit to the developer because of that, only to the people who purchased the bonds.

"So the argument is either a deliberate attempt to unfairly paint developers as gaining an unjust return, or an example of the ignorance of people who make these false accusations."

Schnitzer also said the projects built after 1981, which included those built at the 13.5 percent interest rate, were limited to a return of 6 percent of the developer's actual equity in the project. And that did not increase for the full term of the contract, which was generally 20 years.

"Why people got into this business is that you had a parallel benefit that went with all real estate-depreciation, which was a help as a tax shelter, and that exhausted after 10 years," Schnitzer said. "So if you had a 6 percent return subject to the regular corporate rate, you're probably getting a return of 3 or 4 percent. Anybody today could get better with government bonds. "(Kafoury's) arguments were simply a means of trying to push through this legislation in order to try and capture the equities that people have put sweat and money into in order to provide for their families."

Schnitzer is currently embroiled in litigation regarding a similar preservation ordinance in San Francisco. He predicted that Portland's ordinance, too, would be challenged, either by one of his Portland peers or himself when his contracts end.

"We're not under the gun at this point. . . we have several years to go on our contract," he said. "We will see how things move along; I believe others are contemplating legal action."

Two other owners in Portland said that they are going to test the city's ability to buy the property through a proposed sale. Beardsley is still hoping to get an opinion from the state attorney general on the enforceability of the ordinance.

Madelyn Wessel, Portland's deputy chief attorney, said that "very serious and substantive efforts were made to review the ordinance and the implementing procedures for consistency with federal and state constitutional principals."

Ordinances in other parts of the country, like the San Francisco ordinance that's being litigated, "are far more Draconian in not even providing for a city offer to buy at all," she said. "They are simply ordinances that say you are never allowed to sell, or if you do, you have to replace the housing."

Steve Rose, a former owner of a housing project with a project-based Section 8 contract, said at Kafoury's request he sat on the task force that came up with the ordinance. He eventually left the committee.

"Telling a developer that paid his dues for 20 years that the rules they agreed to have changed and he's not done paying his dues is an inherently un-American thing to do," Rose said.

Said Kafoury: "These tenants, some of them are so disabled that the chances of them finding private-market places that will take them, period, much less take their voucher, are nil. I never believed this was a risk-free decision, but I just don't have a choice. So I guess I'm just an old softie pinko. That's all right. We could use a few more of me."

(Photograph Omitted)

Captioned as: Michael Ellmaker, owner of the Biltmore (above), says the city has placed a lien on The property

GRAPHIC: Photo

UMI-ACC-NO: 9999652
LOAD-DATE: February 18, 1999

Evidentiary Exhibit Number 121

The Philadelphia Inquirer

Found on Philly.com

The Philadelphia Inquirer
JANUARY 24, 1999 Sunday D EDITION
SECTION: REAL ESTATE; Pg. M01
LENGTH: 1143 words

HEADLINE: IT'S UNSEASONABLY HOT AT THE SHORE / IT'S NOT EL NINO. IT'S THE ECONOMIC BOOM. DEMAND FOR RENTAL, SALE AND CONSTRUCTION OF HOMES IS AT AN UNPRECEDENTED LEVEL.

BYLINE: Alan J. Heavens, INQUIRER REAL ESTATE WRITER

BODY:

It's winter even at the Jersey Shore, but you'd hardly know it.

It's not just that winter weather tends to be milder so close to the ocean. The activity level - rentals, sales and construction - is running warm to very hot in most areas.

"The spring market has just become accelerated," said R.J. Soens 2d, a broker at Avalon Real Estate Agency in Avalon. "I haven't had a day off since Jan. 2."

A number of dynamics - changes in society and our attitudes toward leisure time; the booming economy, and interest rates low enough to enable a family to handle two mortgages - have contributed to the three-year boom in sales and rentals at the Shore.

After struggling for several years with a three- to four-year backlog of unsold property, a lot of which had been purchased for inflated prices in the mid-1980s, agents are facing a situation in which there is more demand than supply, depending on the market segment.

The shortages are in the $200,000 to $400,000 range in single-family houses, and in the beach block and bayfront areas from $500,000 and up, Soens said.

"There's a good bit of stuff in the third and fourth block for big money, too, and there's no really weak market anywhere," Soens said. "People are just looking for selection, and there's just not that much available."

There's also a building boom, mostly of second or vacation homes, Soens said, which is slowly eroding the number of rental properties.

"There is a lot of construction, probably more than we've ever seen, but at least more than in the last 10 years," he said. "But at least 80 percent of those are tear-downs of existing beach houses that are being replaced by larger second homes, not rental properties."

In fact, of the 2,500 rental properties Avalon handles annually, only 20 are right on the beach, according to Soens. Most beachfront houses in Avalon and Stone Harbor aren't rentals.

Not all communities are benefiting from the boom. But in many municipalities, the caution that dominated the Shore real estate market in the early 1990s, stung by the overbuilding and overpricing of the 1980s, has been thrown to the wind.

Much of the housing at the Shore, from $150,000 condos to sprawling multimillion-dollar beachfront palaces, is being built on speculation.

"The sales results of the last couple of years, the strength of the stock market, continued consumer confidence all have contributed to this heady feeling," said Paul E. Leiser, principal in Avalon Realty Co.

While confidence in the market is helping push Shore construction, a number of other factors are playing major roles. The second-home market is benefiting from the Tax Reform Act of 1997, which reduced capital-gains taxes to 20 percent from 28 percent on investments held at least 18 months and raised the tax-exempt limit on profits from sales of houses to $500,000 for married couples and to $250,000 for singles.

With continued low 30-year fixed interest rates, it means that a couple in the Philadelphia suburbs can sell the house they bought 15 or 20 years ago at a substantial profit, pay no taxes, and buy two houses. One can be in an active-adult community in the area or in warmer climates; the other can be at the Shore.

Rentals remain plentiful, however, and, as in every year, top-of-the-line properties usually go first, said Doug Grisbaum, a broker with the Berger Agency in Ocean City, which manages more than 3,000 properties.

"Fully half of last summer's vacationers put deposits on rental units for this summer before they left to return home," Grisbaum said. Every year for at least the last five, the booking rush for the following summer has been earlier.

Often, renewing a lease can mean a slight savings for the renter over the next year. The property owner is guaranteed income for the new year even before he or she closes up for the season.

Repeat renters tend to treat the houses as if they were their own, which reduces maintenance and repair costs.

While the season for securing rentals has expanded, there are fewer people physically showing up to look, rental agents said.

"We're seeing more people booking over the telephone," said Tim Richards, owner of the Richards Agency in Ocean City. "Life has changed, and we don't have the time anymore."

At Ocean City, there are a lot of new rentals on the market, as it, too, "has experienced a boom in tear-downs," Grisbaum said.

"But of the duplexes that are being built, only half are for rent," Grisbaum said. "When someone builds a duplex, one of the units is a second home, not a rental."

The second/vacation home trend has pushed sales to unprecedented levels in Ocean City, Grisbaum said.

"In 1997 and past years, there were only three real estate agents who sold more than $10 million in real estate in Ocean City," Grisbaum said. "In 1998, there were 16."

Scott Halliday, president of Halliday-Leonard Co., an Ocean City construction company, built more than three dozen houses on the island last year. He said residential construction hadn't approached the current level since the 1980s, when the firm built continuously.

He said he was building houses for people who have owned property at the Shore for years and want to redevelop and upgrade for themselves, as well as people who live in the Shore homes part of the year and rent them out the rest of the time, and single-family houses for professionals and individuals.

Areas such as Cape May, where construction has been limited because of the city's status as a National Historic Landmark, have seen some building, such as when the Christian Admiral Hotel on Poverty Beach was razed and subdivided for single-family homes.

West Cape May has seen unprecedented construction over the last year, according to builder/Realtor Joe Gilmartin of Cape May. While there has been little demolition of existing structures to make way for new inventory, some lots are selling for $400,000, and the houses on them are costing $500,000.

The majority of these are full-time or second homes, Gilmartin said.

While the inventory of rental properties is slowly dropping as a great number of owners decide to use the houses exclusively, rents are increasing only 5 percent to 10 percent each year. The newest and the best rentals always command the most money and are always the first to go, according to Richards, whose agency handles about 1,000 rentals a year.

"The upscale inventory gives people the confidence to rent without seeing first," Richards said.

Because summers are so busy for agents, one would think the winter would be a nice time for them to take some time off. But in this market, it's just not possible.

"I've been moving a million miles an hour since the ball [in Times Square] dropped" on New Year's, Soens said.

"I hope it doesn't end."

GRAPHIC: PHOTO AND CHART;
PHOTO
Realty broker Doug Grisbaum, on the balcony of an Ocean City shorefront rental property, is ready for what likely will be another boom summer. (ERIC MENCHER, Inquirer Staff Photographer)
A two-unit house on Central Avenue in Ocean City offers four bedrooms and two baths upstairs for a weekly rental of about $4,300. The similar downstairs unit rents for about $4,000.

LOAD-DATE: October 22, 2002

Evidentiary Exhibit Number 122

Business Dateline;
Puget Sound Business Journal
January 15, 1999

SECTION: Vol 19; No 37; pg 7
LENGTH: 927 words
HEADLINE: Low-income housing proposal stirs debate
BYLINE: Peter Neurath
DATELINE: Seattle; WA; US; Pacific
BODY:

Headnote:

Measure would affect sale of subsidized units

Seattle City Council Member Peter Steinbrueck is drafting an ordinance aimed at preserving low-income housing, but local apartment owners claim if would have the opposite effect.

The ordinance would give tenants and groups seeking to save low-income housing a right of first refusal when apartment owners decide to sell units built with government subsidies.

"My basic belief is, it's less expensive to preserve than to replace," said Steinbrueck, who chairs the council's housing committee.

The Apartment Association of Seattle and King County predicts the ordinance would reduce investment in new low-income housing. It opposes the proposed law, and describes it as another step toward rent control.

In an important exception for apartment owners, Steinbrueck said his ordinance would not apply when owners sell one apartment building and buy another in time to avoid capital gains taxes.

He said the proposed ordinance is undergoing its final drafting, and he expects it go before the full council next month.

The ordinance would apply to rental housing built with federal subsidies. In return for the subsidies, owners contract to keep rents affordable for low-income tenants for 20 years.

According to The Tenants Union, the contracts on about 4,000 such units in Seattle will expire during the next two years. "That will create a crisis in affordable housing," said Tenants Union official Siobhan Ring.

The Tenants Union supports the ordinance, but wants to broaden it to apply to all low-income housing.

Council Member Nick Licata said he favors expanding the ordinance to nonprofit housing and, absent legal and practical constraints, also to privately owned low-income housing.

He conceded that doing so would influence the market, and added that possible "unintended consequences" merit study before broadening the ordinance.

Steinbrueck said he, his colleagues and the Mayor oppose broadening the ordinance to unsubsidized, privately owned housing. "That's a clear dividing line," he said.

Last fall, the City Council adopted an ordinance requiring landlords to give tenants 60 rather than 30 days notice of rent increases of more than 10 percent.

Now, a coalition of Seattle tenants called the Local Housing Needs Local Laws is pressing for repeal of the state law barring local jurisdictions from adopting rent-control laws.

Apartment owners fear that these measures are inching Seattle toward rent control. "There's a pattern of piling on more regulations that paves the way," said Steve Excell, a spokesman for the apartment association.

The association argues that rent controls - including required notice of rent increases and regulating the rate of increases - have the perverse effect of hurting the very people they're intended to help.

Many credible studies, the association points out, conclude that developers shun cities with controls and that apartment owners slash building maintenance.

'"This is the kind of thing that makes us not want to invest here," said Apartment Association president Chris Benis of the proposed right-of-first-refusal measure. "It interferes with the normal day-to-day buying and selling of property."

"There are a lot of us, and Pm one, who do not own rental property in Seattle," added Apartment Association past-president and former Seattle Mayor Wes UI-- man.

As a buyer, said Benis, 'would I do the due diligence, have a building inspected, do environmental surveys and line up financing just to sit on my hands and have the tenant buy the building out from under me?"

The Apartment Association of Seattle and King County predicts the ordinance would reduce investment in new lowincome housing.

The Tenants Union makes the opposite argument. "We're not asking owners to give us anything for free. We just want a fair chance to make a fair offer. Our money is as good anybody else's. Owners who sell under the ordinance will get full value for their buildings," Ring said.

Owners argue that values would fall, because the ordinance would deter many potential buyers from making offers.

As drafted, the ordinance would require sellers of "a federally assisted housing development" to notify renters and the city. Within 90 days, interested tenants or lowincome housing groups would have to put up 2 percent of the price and "a fully executed purchase and sale agreement." If the sale didn't close within 180 days of the notification, owners would be free to sell to whomever they wish.

The Seattle King County Housing Development Consortium, a trade association of 23 nonprofit developers, wants more liberal terms than the current proposal offers. It would replace the earnest-money provision with a 30-day letter-of-interest requirement and extend the overall period to 240 days, so there would be enough time to apply for subsidies.

Steinbrueck and the Apartment Association differ over the meaning of "rent controls." The association says controls include required notice of rent increases and regulation of the rate of increases. Steinbrueck calls these measures "rent stabilization."

While he's not in favor of rent ceilings, Steinbrueck said, "I do have an interest in rent stabilization."

This would bring some predictability to rent increases for the 52 percent of Seattle households quartered in rental units, he said.

Steinbrueck said he would like to see rent increases tied more to inflation and increased costs, and less to the "opportunistic rent setting" characteristic of tight housing markets.

UMI-ACC-NO: 9994318

LOAD-DATE: February 3, 1999

Evidentiary Exhibit Number 123

South Bend Tribune (Indiana)

January 2, 1999, Saturday INDIANA, MICHIGAN, MISHAWAKA, PHM, TRIBUNE

SECTION: Home, Pg. c3

LENGTH: 524 words

HEADLINE: Can joint tenant be taken off title without consent?

REAL ESTATE NOTEBOOK

BYLINE: ROBERT J. BRUSS

BODY: Question: About 15 years ago, a favorite aunt and uncle with no children asked to add me to the title of their home as a joint tenant. I didn't like the idea, but they pleaded with me. I relented and assumed responsibility for the property taxes. Several years later, a minister entered their lives and demanded I remove myself from the title. I soon stopped receiving the property tax bills.

On inquiry of the local tax collector, I learned my aunt and uncle had created a family trust with the minister in charge (they gave him power of attorney). I was somehow removed from the title. But the tax collector reinstated my name to the title and tax bill. Can the house be put into a family trust without my consent and signature? What should I do?

Answer: Run, don't walk, to the best real estate attorney in town. If your aunt and uncle executed a deed from themselves to you and them as joint tenants with right of survivorship, your name cannot be legally removed from the title without your written consent. Perhaps your signature was forged. However, your aunt and uncle could put their interest in the property into a family trust without your consent.

Whatever happened, it's time to make sure that minister isn't taking advantage of your relatives. A quiet title lawsuit might be needed to sort things out.

Question: In October, I sold my rental property to the school district for $282,000. I hope to purchase another property for $95,000. Can I get a tax break even though I didn't put the sales proceeds into escrow?

Answer: Please consult your tax adviser. If the school district condemned your property under eminent domain, Internal Revenue Code 1033 gives you at least two years to reinvest the sale proceeds into a similar use property without owing tax on your profit. However, if you made an outright sale to the school district and didn't comply with the Starker tax-deferred exchange rules of Internal Revenue Code 1031(a)(3), then you owe tax on your profit even if you reinvest the proceeds into another rental property.

Question: Can the proceeds from the sale of a limited partnership qualify for a tax-deferred exchange into a rental house?

Answer: No. Limited partnership shares are personal property. They can't qualify for a "like kind" exchange for real property held for investment or use in a trade or business under Internal Revenue Code 1031. Your tax adviser has further details.

Question: I own a one-third share of a property, which I want to sell. I have asked the two other owners if they are interested in buying my share. If they don't buy me out, what are my options?

Answer: Presuming you hold a one-third interest in the property as a tenant in common, you are free to sell your share to whomever wants to buy from you. However, there isn't much demand for one-third of a property.

If your co-owners elect not to buy you out, you could bring a partition lawsuit to force a sale. The judge then decides if the property should be sold and the proceeds divided among the owners. Please consult a real estate attorney in the state where the property is located for full details.
LOAD-DATE: January 7, 1999

Evidentiary Exhibit Number 124

Journal of the American Planning Association
January 1, 1999
SECTION: No. 1, Vol. 65; Pg. 62; ISSN: 0194-4363
IAC-ACC-NO: 53953515
LENGTH: 10867 words

HEADLINE: Incentive property taxation: a potential tool for urban growth management.

BYLINE: Gihring, Thomas A.

AUTHOR-ABSTRACT:

In their efforts to find more effective policies and mechanisms for urban; growth management, planners have yet to step off the regulatory plateau and; discover new approaches elsewhere. The subject of this study undertaken in; Vancouver, WA and Seattle is "incentive" property taxation linked to growth; management. Using county property assessment files, hypothetical tax; applications were performed on classes of land use. Simulating a heavy tax; on land values and light tax on improvement values demonstrated the shifting; of tax burden onto the land-extensive uses associated with urban sprawl,; such as parking lots, and the reduction of tax burden on land-intensive uses; such as apartments and office buildings. The study suggests that property; owners might respond to tax-based financial inducements to reduce the ratio; of land-to-improvements value by building more intensively on underutilized; sites. Prospects for infill development and the appropriation of speculative; gain are also examined.

BODY:

The urban land use planning profession, having received its legal basis historically from state enabling legislation and the local police power, has grown comfortable with the regulatory environment as a modus operandi. Rarely have planners looked beyond regulations for solutions to the twin problems of urban sprawl and central city stagnation. This study opens the case for a revised property tax system, by examining its power to influence land use allocation and its potential as a supplemental tool for managing urban development.

Recently, two vocal environmentalists have raised the issue of property taxes and their effects on the contemporary urban landscape. Both denounce the present system of property taxation as regressive. In his book Home From Nowhere (1996), James Kunstler targets the car-dominated American habitat as a failed experiment, asserting that "our system of property taxes may be the single most insidious, pathogenic factor contributing to the geography of nowhere" (Kunstler 1996). Alan Durning of Northwest Environmental Watch makes the argument in This Place on Earth that the nation's existing tax codes send the wrong message by penalizing work and investment, thereby accelerating urban decline (Durning 1996).

Adhering to a progressive liberal view of economic justice, proponents of the "green tax" movement maintain that value should accrue to the creator of value (Katzenberger 1992). The three factors of production commonly cited as combining to produce wealth are labor, capital, and land, where:

* wages are the return to labor,

* interest is the return to capital, and

* rent is the return to land, or to the steward of land, which is the public domain.

Unlike capital and labor, which are associated with productive enterprise, land refers to the gifts of nature. The mispricing or misuse of these free, fragile natural endowments, limited in quantity, leads to environmental degradation. According to Durning, "Taxes on [land] raise the price of using [it], which tells people to conserve. . . . Taxes on labor and capital tell businesses and households to scrimp on workers and tools - . . . to practice unemployment and underinvestment. A reasonable tax policy would tax the gifts of nature first and tax labor and capital only as a last resort" (Durning 1996, 227).

The alternative method proposed by Kunstler, Durning, and a growing number of environmentalists and converts to neotraditional planning rests on a foundation laid by a nineteenth century reformer. In his seminal book Progress and Poverty, the political economist Henry George laid out his fundamental premise for reform: the abolition of involuntary poverty by opening the earth's resources on equal terms to all. Wider access to land could be accomplished, he argued, by reducing taxes on wages and capital and raising taxes on land holdings. That would induce owners of unused sites to sell them at reasonable prices, thus bringing idle land into productive use and creating more employment (George 1880).

The basic principle recognized by land value taxation is this: land value accrues cumulatively, in a process generated by the community as a whole; as such, that value belongs to the community; it is only the building value that is created by private capital investment, and as such, belongs to the owner. Hence it is just for the public sector to appropriate land rent through taxation.

In its pure form-the abolition of all taxes save the tax on land-Henry George's theory was never actually applied. The idea of differential taxation, however, lived on and was incorporated into law in several British Commonwealth countries, Taiwan, Denmark, Holland, and two states in the United States. The city of Pittsburgh adopted land value taxation (LVT) during the municipal reform period of the 1920s, and several jurisdictions followed suit under Pennsylvania enabling legislation (Pickard 1962). In 1993, New York State adopted legislation allowing local use of the two-rate system. The stated aim was to stimulate development by increasing tax rates on land and reducing rates on buildings (Hennessy 1993).

Elements of Land Value

In contrast to the conventional, equal-rate system that applies the same tax rate to land and to improvements, a revised two-rate property tax structure taxes the assessed land value of each parcel at a higher rate than that on the building assessment. The two-rate system's rationale is exemplified particularly clearly in urban areas where land value is largely site value, that is, the market value generated by the presence of public infrastructure, nearby public and commercial facilities, natural amenities, and accessibility (Mills 1969). Thus, in principle, this heavier tax on land taxes mainly the land rent (or economic rent) created over time by the community at large, not the capital invested in the property improvements.

A second point here is the effect of the taxation system on owners' decisions about improving property. In practical terms, for individual owners the market value of land is the speculative value of the given sites. We have noted that as land values rise, the increases can be preempted by owners through higher resale prices, or they can be captured (at least in part) by the public sector in the form of tax revenue. If an owner undertakes no capital improvements on a property, the future resale profit from that landholding is a purely speculative gain, or windfall; if the owner does add improvements, they also add to the amenity of the area, and thus create an increment of community wealth. But under the present equal-rate system of taxation, the owner has no tax-based incentive to invest in property improvements, because doing so will result in higher taxes. Thus, inherent in the equal-rate method of property taxation is a built-in disincentive to invest in substantial capital improvements.

Benefits of Land Value Taxation

Land use decisions by individual property owners could be affected by taxation if the financial incentives or disincentives were sufficiently strong in proportion to the full economic rent. That is, if the additional tax burden imposed on land by converting from an equal-rate tax to a land-based tax were to approach the speculative gain derived from land value inflation, an owner may decide to convert to a more building-intensive use or to sell the land to a buyer willing to undertake a substantial capital investment. Proponents of two-rate incentive taxation anticipate several significant benefits to the public interest (Gaffney 1993). They are elaborated below.

1. Placing proportionately higher taxes on land would make it more costly to hold on to vacant or underutilized, centrally located sites. Trends toward infill development and a gradual recentralization of urban development would emerge. The demand for peripheral sites at the urban fringe would correspondingly diminish.

2. Reducing the tax burden on improvements would facilitate revitalization and the replacement of obsolete buildings in older central cities. Property owners, responding to the financial inducement to reduce the land-to-building value ratio, would build more intensively on vacant and underutilized sites. The cumulative effect over time and space would be to increase property values, and thus the tax base, where that is most needed.

3. The two-rate tax would discourage land speculation, that is, the holding of unimproved or under-improved property for the purpose of reselling profitably without any substantial capital investment. A differential tax rate that was high compared to land price inflation could diminish the accumulating windfall for the holdout owner. That is, if the tax would capture a large portion of the land's economic rent, the owner would in all likelihood capitalize the depletion into a lower resale price.

Urban Growth Management

The previous discussion makes apparent the close relationship between the expected benefits of land value taxation and the commonly stated objectives of urban growth management (UGM). In general, UGM seeks to promote a suitable relationship between land use and infrastructure, that is, more efficient use of land in order to conserve land rather than consume it (Gallion & Eisner 1980). Land use efficiency can be achieved through compact urban form, establishing ordered relationships among the places devoted to utilitarian functions such as work, shopping, recreation, and socializing, and at the same time maximizing their compatibility (by defining zoning districts), maximizing accessibility (by designing a balanced transportation system and reducing distances between origins and destinations), and minimizing energy consumption.

Although the rationale for land value taxation is independent of UGM, the overlap of purpose is clearly discernible. In essence, the double-sided coin of incentive property taxation has these two principal objectives (Rybeck 1992):

1. Tax away the speculative value of property, by rewarding capital investment.

2. Bring idle land into production, by penalizing speculative land holding.

A two-rate system's expected outcomes can be summarized as follows:

* Discourage urban sprawl

* Encourage infill development

* Discourage building disinvestment

* Intensify land development

* Discourage land speculation

* Restrain rising residential land prices

The overlap between incentive property taxation and UGM can be seen in the legislation adopted by the state of Washington in 1990. Emulating a model established by several precedent-setting states such as Oregon, California, and Florida, the Washington State legislature in 1990 adopted the landmark Growth Management Act (GMA), a comprehensive set of goals, strategies, and enforcement provisions to guide land development (Washington State Growth Strategies Commission 1990). The state's growth management objectives can be summarized as follows:

* Preserve rural open space and resource lands

* Prevent sprawling, low-density development

* Direct new growth to existing centers

* Encourage infill and contiguous development

* Encourage redevelopment in economically depressed sub-areas

* Revitalize declining central business districts

* Use public infrastructure more efficiently

* Reduce automobile dependency; support transit and pedestrian modes

Applying Incentive Taxation

To date, only limited attempts have been made to use the public's power of taxation to achieve growth management objectives. Both Washington and Oregon have adopted the practice of assessing farmlands, open space, and forestlands at current use value rather than full market value (that is, exchange value). The intent is to encourage farmers and foresters, through lower taxes, to continue natural resource-based economic activity and to resist the temptation to sell lands located in the urban fringe for development (Washington State Dept. of Revenue 1993).

Negative applications of incentive property taxation also are legally available but, again, in only limited use. The state of Vermont uses a Land Gains Tax to protect rural land from short-term speculation. A high capital gains tax on resale within a one- or two-year period targets owners whose intent in buying up resource lands was to profit from their conversion to urban use, and allows local jurisdictions to capture up to 80% of such windfall profits (Daniels, Daniels, and Lapping 1986).

Even less used are tax mechanisms that incorporate both rewards and restraints concurrently. Planners and lawmakers could profit by examining more carefully how incentive taxation could be used to simultaneously encourage wise land use practices and discourage land speculation and sprawling development.

The Two-Rate Taxation Method

Under the conventional, equal-rate property tax system, each owner's tax bill is prepared by multiplying the total assessed value (TV) by the levy rate, usually expressed as a per-thousand-dollar figure, or mill rate. For example, if the assessed value of a given property were $ 100,000, and the levy rate were $ 13 per thousand of assessed value, the tax bill would be $ 1,300. In each county the assessor calculates the levy rate by dividing the

total projected revenues authorized for the various taxing districts by the total assessed value of real estate in the county. To find the mill rate, the resulting ratio is multiplied by 1,000.

Under the alternative two-rate property tax system, the total levy rate is split, and applied differentially to land values (LVs) and to improvement values (IVs). The assessed land value of each property is multiplied by the higher fraction of the levy rate, and the assessed building value is multiplied by the lower fraction. In this study, the proportionate rates for land and buildings are derived from a land value tax (LVT) level denoting the percentage of the levy rate that the taxing authority chooses to apply to the land value.

The two methods of taxation are illustrated in the following example of a $ 13 levy rate applied to a $ 100,000 property:

Conventional Application:

LV: $ 40,000

IV: $ 60,000

TV: $ 100,000 $ 100,000 / 1,000 x 13 = $ 1,300

Two-Rate Application:

(Using an LVT level of 75%, the total levy rate of $ 28.85 is the rate required, when multiplied by the land and improvement ratios, to produce separate mill rates that will yield the revenue-neutral tax of $ 1,300.)

LV: $ 40,000 $ 28.85 x .75 = $ 21.65 $ 40,000 / 1,000 x 21.65 = $ 866 IV: $ 60,000 $ 28.85 x .25 = $ 7.25 $ 60,000/1,000 x 7.25 = $ 434

TV: $ 100,000 $ 1,300

Note that, in practice, the concept of revenue neutrality applies not to single parcels but to an entire taxing jurisdiction. Thus, individual properties' tax bills may be either higher or lower as compared to the conventional tax, though all are taxed under the same set of differential rates.

There is general agreement among the advocates of land value taxation that a two-rate system should be introduced gradually so as to minimize the effects of any abrupt change in tax billing for the owners most affected by the differential tax. A phase-in period gives the property owners whose taxes rise an opportunity to gradually adjust property prices downwards, as the capitalized market value of their land diminishes because of the land value tax (Congressional Research Service 1971). The phase-in also gives owners time to adjust their investment decisions. For example, the anticipation of increasingly higher land tax burdens may prompt the earlier sale of underutilized property, or investment in building improvements. A transition period-maybe ten years, more or less-during which the levy rate differential gradually would rise to a concluding level, perhaps short of a 100 percent land value tax, would avoid undue financial stress on land owners. Figure 1 contains the derived mill rates for a revenue-neutral tax application during a simulated phase-in period when the land tax rate is raised incrementally. The initial rate for the Vancouver area is the current conventional rate of $ 13.93 per thousand assessed valuation.

What is an appropriate concluding LVT level is subject to a variety of opinions. One would hope the rate differential would be enough to appropriate a substantial portion of the land rent within a taxing jurisdiction. In urban areas where growth pressures are strong, high land value inflation would be expected. Consequently, higher LVT levels might be needed in those areas to recapture the annual gains in land value. Where the real estate market is soft, however, too high an LVT level could trigger a shock wave that depresses property values

excessively. In terms of the public interest, one could also aim for incentive effects that generate property upgrading and infill development activity.

There is no logical reason not to consider a full tax on land values (excluding an improvements tax). However, the choice was made in this study to advance a method which has some precedent in the United States, namely the Pennsylvania "two-tier" system. In any case, the amount of land rent captured by a full LVT would differ only minimally from that recovered by the 95% LVT utilized in this study.

A series of hypothetical two-rate tax calculations are run on aggregations of assessed value representing classes of land uses. The series of applications consists of six progressively higher LVT levels, illustrated in figure 1. The derived tax rates, adjusted for revenue neutrality, yield the same total revenue as the conventional rate applied to all properties in the Vancouver urban growth area of Clark County, Washington.

Figure 2 illustrates the application of a graduated two-rate tax rate to the land and improvement assessments on a typical single family residential parcel valued at $ 173,725; during the phase-in period, the tax on improvements gradually decreases and the tax on land assumes greater proportions. In this particular case, the total tax bill decreases over the phase-in period. In the aggregate, the tax burden would be reduced for some properties but increased for others; the total revenue collected would remain the same.

The Vancouver-Clark County Setting

This study is designed to simulate the fiscal effects of a two-rate tax on properties in the 80-square-mile Vancouver, Washington urban growth area (UGA). This setting offers an opportunity to examine the possibilities of using the incentive power of land taxation in concert with the state's GMA regulations to bring about a more effective means of managing urban growth. Although the conclusions are preliminary, the study attempts to test the hypothesis that both LVT and GMA objectives can be achieved by changing the conventional taxation system to a two-rate land value tax system.

Clark County is the fastest growing county both in the Portland metropolitan area and in Washington State. [ILLUSTRATION FOR FIGURE 3 OMITTED.] Population increased 21 percent from 1990-1995, to over 290,000, and is expected to grow by 134,000 persons over the next 20 years. In 1980 about 22,000 Clark County residents were crossing the Columbia River to work sites in Oregon; by 1990 the number had increased to nearly 37,000. This amounts to a third of the county's work force (Nokes 1995).

The county's role as a bedroom community is reinforced by the tax disparity between Oregon, which has a personal income tax, and Washington, which does not. Oregon also has no sales tax, whereas Washington (Clark County) imposes a tax of 7.6% on nonfood goods and services. Consequently, many Clark County residents work and shop on the Oregon side of the Columbia River though they sleep on the Washington side. The long-term result is that Vancouver's central business district (CBD, located on the edge of the state boundary) has languished. Measured in total assessed value, downtown properties classified as general merchandise retailing account for only 1.4% of the UGA total. A markedly high parcel count in the land use class for parking-over three-quarters of the Vancouver UGA total--suggests that a significant amount of centrally located land area is given over to automobile-related uses.

Much of the current construction boom is in the eastern sector of Vancouver, near the urban growth boundary adjacent to the town of Camas, where new manufacturing plants have located. Recently, a Taiwan-based semiconductor corporation named the Cascade Business Park as its choice for a $ 1.2 billion manufacturing plant that will employ 800 workers by the end of the decade, and is planned to expand to an eventual work force of 7,000 (Paulson 1996). Comparable expansion activity is anticipated in the area seven

miles north of downtown Vancouver, where a new 348-acre branch campus of Washington State University has recently opened.

Urban Sprawl

Concurrently with rapid population and employment growth, raw land is being developed to accommodate housing, industry, and commerce. Land conversions near the urban fringe seem to occur despite the availability of buildable sites within existing urbanized areas. Clark County files of subdivision and building permits show that a land rush of sorts occurred in anticipation of the Vancouver urban growth boundary designation in 1994 and its attendant rezoning. Developers and resident owners expanded urban development into semirural areas, appropriating buildable sites on scenic hillsides and riparian lands.

The corollary of rapid population growth and a high rate of land consumption is low-density urban sprawl, which manifests itself in two ways: (1) leapfrog development and (2) low-density development or extensive land utilization. The antithesis of these sprawl conditions can be found in the GMA objectives listed earlier: (1) centralization (centripetal not centrifugal forces guiding the path of development), as well as contiguous development patterns; and (2) compact, higher-density, or intensive land utilization.

By documenting the location and quantity of both vacant and developed sites, it is possible to measure the extent of urban sprawl.(1) A leapfrog pattern of development is evidenced by the large number of vacant sites found in the inner suburban ring, and lower proportions of vacant sites in some outlying areas. Under a hypothetical "no sprawl" pattern wherein overall vacant site ratios do not exceed that of older sections of the city, the lateral extent of urbanization would be constricted to an area only 63 percent of the current urbanized area. The pattern of scattered, low-density development is firmly imbedded in the regional landscape.

Associating Land Utilization with Land Value Assessment

With reference to the problems of urban sprawl and the GMA objectives that counteract them, the following research questions arise:

* How might a land value tax affect owners' decisions about land utilization?

* Would shifting the property tax burden onto vacant and underutilized sites create enough financial incentive to stimulate more contiguous development of land within the urban growth boundary?

* Would tax burdens on downtown vacant and underutilized sites induce centralization and revitalization?

* Would a lower tax on improvements facilitate the eventual replacement of low-intensity uses with more building-intensive uses, as envisioned by the Clark County Comprehensive Plan?

To know whether property taxation has any effect on land use, it is necessary to establish an operational relationship between the two concepts. From the planners' perspective, the key to efficient land use is compact urban form, which is a function of development intensity, and can be measured at its most elemental level as building area coverage. But intensity is a physical phenomenon, not a fiscal measurement. If there is found to be a positive correlation between building intensity and the monetary value of improvements relative to land, then the intensity at which land is used would be reflected in property assessments, the basis for determining tax burden.

Building intensity as a physical measurement of site utilization is expressed as a ratio. Dividing a building's internal square footage by the lot's square footage yields a floor area ratio (FAR). Put in valuation terms, building intensity is the building value to land value ratio (BLR). Table 1 contains the aggregated figures from which the site ratios and value ratios are derived.(2) If value ratios correlate with site ratios, then one can expect

land value taxation to affect properties according to their intensity of use. That is, on a given parcel the tax burden shift accompanying a change from the conventional to the two-rate system would coincide with the intensity of use. Properties having substantial improvements relative to the land area could anticipate lower taxes, while vacant sites and properties using extensive land areas and with only marginal improvements could expect higher taxes.

Although the number of land use categories is small, it can be seen that building-to-land valuation ratios (BLRs) do generally compare with building-to-lot area ratios (FARs), especially when the three single-family housing types are collapsed into a single category. On average, FARs are about 6% of the BLRs (or 56% if a factor of 10 is used for a clearer graphic illustration). This association is illustrated in figure 4, where the right-hand column represents the overall average.

The notable exception to this norm occurs within the single-family class of properties. Small, single-family lots are found to use about 29 percent of the lot area as building floor space, but large-lot parcels use only about 6 percent of the lot area as building space. Nonetheless, the valuation ratios for these two categories are not very different. Mean lot sizes in the large-lot category are six and a half times the mean size of small-lot parcels, yet their current assessed land value is less than double the mean value of small-lot parcels. Even within geographic sub-areas (-square-mile sections) where unit site values are expected to be comparable, larger single-family developed lots are consistently valued lower on a square footage basis.

The implication is that the land components of large-lot, single-family land parcels are assessed at a level below what their site use would indicate.(3) Therefore, as current assessments now stand, two-rate results for this particular category will not be consistent with the intensity of land use. The results of this test of association are that, generally, there is a relationship between building intensity and the valuation ratio, which itself determines the degree of tax burden shift. With the exception of large-lot residences, of which there are many, the tax burden for land-extensive uses can generally be expected to rise under the two-rate system.

The L-TV Ratio

The key variable in two-rate taxation methodology is the ratio of land value to improvement value. This study, however, adopts the expression of land-to-total value (LTV) as the preferred measure. This measure, the proportion of assessed value attributed to land, determines the degree of the tax burden shift caused by the transition from the conventional tax to a two-rate application. The [TABULAR DATA FOR TABLE 1 OMITTED] measure can be applied to single parcels or to aggregations of parcels. For the Vancouver UGA, the overall ratio of .31 is derived by dividing the summation of assessed land value - $ 2.7 billion - by the summation of total assessed value - $ 8.8 billion. In terms of the building-to-total value ratio, which is the reciprocal of the L-TV, the average property contains a building valued at 69 percent of the total assessment.

Under the conventional tax system, the value of site improvements as a proportion of the total property value would make no difference in the tax outcome. Under the two-rate system, the county-wide L-TV ratio determines the breakpoint at which tax burden shift occurs. With land taxed at a higher rate, any property having an L-TV higher than 0.31 would be taxed more than it would be under the equal rate system; any property with land comprising less than 31 percent of the total valuation would be taxed less.

The shift in tax burden under the change from the conventional to a two-rate application is expressed as a percentage, or rate of change in the tax amount, using the conventional tax amount as the base figure. This is illustrated in figure 2, where the difference between the column height of the conventional tax amount and the column height of any selected LVT application represents tax burden shift. Simulated two-rate property tax

applications were performed at all five levels of land value taxation, beginning at a 55 percent tax on land and concluding at a 95 percent tax on land. The local tax rates used are those shown in figure 1.

Tax Impacts on Land Use Classes

The overwhelming numbers of single-family residential properties drive the outcome of the two-rate tax application. This land use category consists of over 53,000 parcels, or 80 percent of the total properties in the Vancouver UGA. It accounts for 68 percent of the total assessed value and tax revenue collected within the UGA. (See table 2.) Because of differences in lot size and value, as well as in building size, value, and condition, the land-to-total-value (L-TV) ratio varies within this class of properties; the overall ratio is 0.30. This category's L-TV ratio, which is lower than the overall ratio of .31, is the first indication that single-family residences, as a group, can expect a slightly reduced tax burden under a two-rate application, thereby shifting the burden onto other uses.

Table 3 compares the results of a conventional tax application to the 95 percent LVT, for seven major land use categories. At this highest LVT level, single-family residential properties have a 4.5 percent decrease in tax burden. Multifamily housing types receive the most significant tax break under the two-rate system-a 34 percent reduction. Vacant or unused sites receive the largest tax increases, beginning at 12 percent under the initial [TABULAR DATA FOR TABLE 2 OMITTED] 55 percent LVT level, and concluding with a 162 percent increase. Under the conventional system, vacant parcels, which comprise about 11 percent of all Vancouver UGA parcels, contribute only about 5 percent of the total revenue. Under the two-rate system their revenue share rises to 12.4 percent, offsetting the downward revenue shifts in all developed residential parcels combined. As might be expected, commercial uses vary widely in the intensity of land use. In the Vancouver UGA, retail sites appear to be used less intensively than industrial/manufacturing sites. Indeed, a cursory field inspection reveals that strip or auto-related retail configurations predominate in both city and suburban locations. Overall, the upward tax burden shift onto subcategories within the retail/food service land use type ranges from 2 percent to 26 percent, resulting in an average per-property tax increase of about $ 2,000 under the 95 percent LVT hypothesis.

Thus far, the analysis of tax shifts supports the general premise that the consequences of a two-rate tax system are related to the intensity of land utilization. But when the single-family use category is broken out by parcel size, differences appear. Tax application results (not shown) reveal that under a two-rate hypothesis, taxes are reduced for all sub-classes except large-lot, single-family properties (exceeding 12,000 square feet), where the mean tax increase is a modest $ 211. If land assessments reflected lot size, the tax shift would be considerably higher. Also noteworthy is a greater downward tax shift for medium-lot parcels (-13.2 percent) as compared to small-lot parcels (-5.6 percent).

[TABULAR DATA FOR TABLE 3 OMITTED]

Tax Impacts on Underutilized Sites

Two primary purposes of land value taxation have been identified: taxing away the speculative value of property, and bringing idle land into production. The demonstration here that the general effect of LVT is to tax vacant parcels and land-extensive uses more heavily, raises two questions:

* Does this tax shift create enough incentive to discourage land speculation, that is, to encourage either sales of land holdings or more intensive site development?

* Would the tax encourage infill development or a more contiguous development pattern?

Land Speculation

To realize the first aim - discouraging land speculation - tax revenues must capture a substantial portion of the economic rent on these sites. One way of looking at this possibility is to capitalize the two-rate tax liability over a holding period and compare it to the land value residual. If the appreciation on land plus whatever net income or worth is derived from the site with property taxes paid is less than the return on an alternative investment, then the owner's investment decision may be to sell sooner or convert to a more land-intensive use. Table 3 shows that under a 95 percent land value tax, the tax burden shift on vacant sites from the two-rate system amounts to an increase of 162 percent over the tax under the conventional system. For the average site, this is an increase from $ 822 to $ 2,154. The question is whether this higher tax liability offsets the annual appreciation in land value.

An alternative approach to the problem is to simply compare the annual tax liability with the annual increase in land value on sample properties. Property sales records reveal the extent to which land values have been rising in Clark County (Clark County Department of Community Services 1996). During the period 1990-1995, average site sales prices rose from $ 39,500 to $ 80,300, resulting in a remarkably high average annual rate of increase, 15.2 percent. The following analysis assumes that an owner of a vacant parcel can appropriate this amount of gain each year the property is held. This gain of course is potential; it would be realized only if the site were sold at market value. To differentiate "speculative" gain from simple appreciation in value, the general monetary inflation rate, estimated to be 3.7 percent per year, is subtracted from the total increase in land value over the period of the calculation, eleven years. Tables 4 and 5, and figures 5 and 6 represent "recapture scenarios" for a typical five-acre, exurban vacant site near the eastern fringe of the Vancouver UGA.

Table 4 compares biannual land value increases and speculative gains with biannual tax liabilities over a phase-in period of eleven years. The second line shows how the land value of the subject parcel increases at the second year of each two-year period, and the third line shows the annual net increase (11.5 percent) in speculative gain at those years. Both conventional and two-rate taxes, reported in constant dollars, are shown for the projected land values at these years.

It is evident that under the trend growth rate scenario, the conventional tax can recover only a fraction of the annual speculative gain in value. The tax on land, valued in the third year at approximately $ 423,000, amounts to about $ 5,900, in comparison to the annual speculative gain of about $ 41,000 - a recapture rate of 14 percent. The next lines of the table show the effects of a phased-in, differential rate tax. At year three, a 55 percent LVT recovers 16 percent of the speculative gain, marginally [TABULAR DATA FOR TABLE 4 OMITTED] more than the conventional tax does. By the eleventh year, a 95 percent LVT captures as much as $ 18,300, but by this time the annual speculative gain in land value is over $ 97,000. Nevertheless, the two-rate tax captures 53 percent of the projected gain, in contrast to only 19 percent captured under the conventional tax that year. Note (Figure 5 represents these results in graphic form) that the recapture rates on a typical vacant parcel in the city center are almost identical.

Common sense would probably conclude that the high rate of growth in land values in Clark County during the past several years cannot last. If general inflation in the regional economy remains just under 4 percent annually, a 15 percent growth in land prices is too great a difference to be sustained. After ten years the vacant exurban site now worth $ 319,000 would be valued at $ 1.3 million under a trend growth rate scenario. But on the other hand, if the growth rate in Clark County property values were to decline gradually, would the land value tax then be able to capture the better portion of the speculative gain?

Table 5 presents a reduced growth rate scenario, using the same subject property, in which annual growth rates in land value decline steadily from 15.2 percent in the base year to 8 percent in year 15, as shown on the first line. As in the trend scenario, the two-rate tax is graduated. Results show that as land price inflation decreases, the amount of speculative gain captured by the differential tax increases significantly, as depicted graphically in figure 6. By the tenth year of the reduced growth rate scenario, the two-rate tax captures over 90 percent of the gain, and probably influences land allocation decisions.

If, according to reason, a high growth in land values is not sustainable, the application of a land tax would itself account for part of a reduced rate. Over time, land market values throughout the sub-regional market would show the dampening effect of increasingly high two-rate tax burdens on vacant sites, capitalized into lower resale prices.

The evidence of the reduced growth rate scenario supports the conclusion that an incentive tax policy that dampens high growth rates in land prices may also restrain land speculation by capturing a larger portion of the speculative gain. It is also evident that the conventional tax falls far short of capturing this unearned increment and affecting either land prices or land allocation decisions towards favoring capital investment.

Contiguous Development

From the point of view of growth management, one goal of land value taxation might be to have owners' tax burden shifts prompt their decisions to intensify development within urban centers, thus deflecting the pressure on land conversion at the urban fringe. However, this result would be conceivable only if land values and tax burdens were low in the fringe areas and high in the urban centers. Within the Vancouver UGA, a considerable unevenness is found in the land price topography. Measured in unit (per square foot) figures, the assessed market values of residential sites range from over four dollars to less than one dollar on sites near the urban [TABULAR DATA FOR TABLE 5 OMITTED] growth boundary. However, unit prices drop rather quickly outside the downtown area. Immediately northeast of the CBD, mean land values are less than two dollars per square foot; some land values in more outward areas rise to well over that figure.

A more detailed examination of tax effects in geographic sub-areas is accomplished by identifying mile-square survey grid sections that delineate three urban growth corridors extending north, northeast, and east from the CBD. The results of a simulated two-rate tax application on properties within these sectors show no linear relationship between distance from city center and tax burden shift, among either vacant or developed parcels. The LVT is not differentiated geographically between centrally located sites and distant sites. Centralization as a key objective of urban growth management cannot be achieved, under these circumstances, through the application of LVT to individual parcels.

Infill Development

Ideally, under the two-rate system tax burdens would be highest in urban centers, where the presence of substantial building improvements could be expected to result in large tax reductions, and where vacant and underutilized sites would have heavy tax increases, thus providing financial incentives to bring about infill development and general upgrading. The LVT data for Pittsburgh and other cities where development effects have been documented tend to support the notion that the real power of incentive taxation is to stimulate central city revitalization (Oates and Schwab 1992).

The central business district of Seattle is chosen as a subject for this analysis because of the evidence of recent speculative activity in the midst of renewed investments in building improvements. King County assessment records reveal that land values have been rising. Countywide land values during the period

1985-1995 are calculated to have risen, on average, 8.9 percent annually. For purposes of illustration, it is assumed that long-term owners of downtown sites are in a position to realize the total value of this rate of increase for each year that their properties have been held. The analysis views a portfolio of twenty-eight parcels owned by the Samis Land Co., which recently were entrusted to new management for the purpose of improving their value and use. Historically, the disincentives inherent in the conventional property tax system have offered little redevelopment inducement to Samis, which ". . . owned more property in downtown Seattle - and had done less with it - than any other private landowner in the city" (Keene 1996, A1). Might an alternative two-rate tax have induced the owners to redevelop these properties sooner, rather than to hold the land for speculation and dampen the general climate for reinvestment?

The method of illustrating the hypothesized tax effects is similar to that in the Clark County example. It is assumed that the taxing jurisdiction phases in the two-rate tax in two-year increments, raising the LVT level initially by 5 percent, and then by 10 percent at each biennial reassessment period. The Seattle school district's 1995 conventional mill rate of $ 10.95 is used to derive the differential rates for a revenue-neutral tax application. The rate at which improvement values rise is assumed to decrease, reflecting building depreciation levels prevalent in King County. According to these assumptions, projected land values would increase from the base year by a compounded rate of 8.9 percent annually. From this growth rate is subtracted a long-term general monetary inflation rate of 4 percent, for an annual rate of speculative gain of 4.9 percent. The recapture scenario, summarized in table 6 and illustrated in figure 7, uses two Samis properties and one comparison building.

The Douglas Hotel. Like six other buildings in the Samis portfolio, the Douglas Hotel had been in deteriorated condition, so its improvements are assessed at a nominal $ 1,000. By Year 3, when the lowest gradation of the two-rate tax is in effect, the conventional tax captures only 25 percent of the annual speculative gain, while the [TABULAR DATA FOR TABLE 6 OMITTED] differential tax captures a slightly higher percentage. By Year 11, when the highest LVT ratio is in effect, the conventional tax captures a third of the speculative gain, but the differential tax recovers more than three-quarters of the annual gain.

The Schwabacher Building. This building is more typical of the Samis holdings. Improvements are valued at $ 295,700, yielding an LTV ratio of .63, considerably higher than the overall county ratio of .43. The recapture rates of the conventional tax are higher than those for the first building, simply because improvements comprise a greater proportion of the total value. However, the two-rate tax recapture rate rises more rapidly, appropriating 26 percent more of the speculative gain by the time a 95 percent LVT is phased in.

The Third Avenue Office Building. Because the improvement value ($ 137,240,000) contributes substantially to the total property value of the Third Avenue Office Building, conventional taxes on this premium comparison property are high in the base year and increase during the eleven-year period as land and building values appreciate. In fact, in every subsequent year the tax bill far exceeds the total annual speculative gain on land value, thereby appropriating a large share of the owner's return on capital investment. This illustrates the built-in disincentive of the equal-rate tax system. In contrast, the two-rate tax during the phase-in period quickly compensates for the disincentive by lowering the tax ratio on improvements, from the point at which 164 percent of the gain in value is captured to a recapture rate of 97 percent. Tax liability gradually diminishes during the phase-in period, yielding an annual savings to the owner of almost $ 2 million by the eleventh year. Thus, capital investment in building improvements is rewarded through the incentive of lower taxes.

Within the parameters of this study it is impracticable to predict the type of investment decisions that Samis Co. or other property speculators might have made under the taxing systems compared here. To do so would

require calculating land value residuals on each property by devising hypothetical proformas to incorporate holding expenses, net operating income, and such capitalized costs as demolition or rehabilitation that buyers might want to negotiate. Nevertheless, the incentives simulated in this scenario do point in a positive direction. The two-rate system appears to substantially penalize the practice of disinvestment, and to reward efforts to improve downtown commercial properties.

Unit land values in the Seattle area are over twelve times those in Vancouver, so in absolute dollar amounts the tax burden effects are substantial. Tax recapture rates are higher in Seattle not because of the higher land costs, but because inflation rates for land values are lower. Because recapture rates are negatively associated with the rate of land value inflation, the policy objective of LVT should be to bring down land price inflation by taxing properties at levels as close to the speculative value of land as possible (full land rent), regardless of the dollar amounts and regardless of their location. In the Vancouver UGA, land values are not much lower in exurban areas than in some central city and suburban areas. This is because the speculative value rather than the use value prevails. Speculative land values often drive developers further out into the urban fringes, thus advancing urban sprawl and exerting upward pressure on land prices, in successive waves.

Evaluation of Two-Rate Taxation

Following the mandate of the Washington State Growth Management Act (GMA), Clark and King county planners are endeavoring through the regulatory mechanisms of zoning and urban growth boundaries to impede the rapid advance of urban sprawl. This study's analysis strongly suggests that their efforts could be reinforced if legislators and other governmental departments would join in revising the property tax system to offer built-in financial incentives.

Growth Management

The results of the analyses of differential property tax applications show that the alternative tax system does have the potential to produce some of the effects associated with growth management objectives. Under present circumstances, however, there are limitations to that potential.

Centralization. First, centralization as a GMA objective cannot be achieved through LVT alone. Unless subregional land value gradients are sufficiently steep, peaking at a central core, the land-based tax system cannot exert a centripetal force on development. Through uncoordinated economic development policies that allow new major growth attractors to be sited in predominantly undeveloped locations, Clark County appears to be, by default, developing around multiple nodes while ignoring established centers. This only increases land speculation, pushing up land values in outlying areas.

Intensification. For the GMA objective of development intensification, the alternative tax system holds considerable promise. The fiscal incentives observed here are consistent, for the most part, with the desired outcomes of rewarding land-intensive uses. However, when land value assessments are not commensurate with lot size, the power of the two-rate tax to induce infill and more intensive development is limited. On sites with low-intensity uses, excessively low land assessments can produce the anomaly of tax reductions rather than tax increases.

Anti-speculation. As for the anti-speculation objective of land value taxation, LVT offers much better prospects for capturing land rent and dampening land market prices than does the conventional system. LVT's potential for immediate results in the rapidly growing area of Vancouver is limited only by the current high rate of land value inflation. However, the application of the two-rate tax would itself help to dampen land price

inflation. Being broad-based, the LVT would be likely to arrest the current high rate of land price inflation in the sub-region, as the added tax liability on land-extensive uses was capitalized into lower selling prices.

Infill development. As for infill development, LVT could precipitate capital investment in buildings, if not in response to the negative incentives, then for the prospect of lower taxes on improved properties. Yet, in instances where land value inflation is high, even a 100 percent land tax would not (in a static model) recapture amounts approaching the annual gain in speculative value on underutilized sites. In such circumstances it might appear that only the "pure" Georgist principle of taxing full economic rent (by raising overall tax rates) would achieve the goal of influencing owner investment behaviors and dampening land value inflation. However, even under the less radical two-rate structure, land value inflation would gradually decrease as an effect of higher taxes on land. Eventually, lower land values would necessitate upward adjustments in the tax rate in order to achieve revenue neutrality.

Other Considerations

Only time and experience will tell whether financial incentives as a management tool could eliminate the need for some GMA regulations. It does seem apparent that certain legal mechanisms would be needed to prevent premature land conversion in outlying locations. The dilemma of using incentive taxation for fringeland sites and is that the greater the margin between use value and market value, the greater is the impact of the tax. Because a high tax on resource lands and open space reserves works against their preservation, a means of reducing market values to use value levels is needed. In this case, effective zoning to preclude urban uses in holding zones may be the only way to dampen speculation by constraining the rise in market values.

In Vancouver and environs, land value taxation could become a powerful accessory to urban growth management if the size of the wide-open urban land development market there were effectively constricted. What are now less desirable central areas would become more appealing to residents and merchants as incentive-driven, infill development changed the character and image of these depressed-value pockets. In the long term the central city would revitalize, as rising land values and new capital investment expanded the tax base.

Thus, tighter growth restrictions coupled with LVT will in time produce dynamic effects. Constricting the size of the sub-regional land market will have the immediate effect of pushing up land values inside the growth boundary; but a land-based tax will counter that trend by pushing them downward. Then, after the positive incentives take hold, property values as a whole will increase in re-centralized areas where infill and redevelopment have taken place.

Regulatory Adjustments

The policy objective of limiting the overall size of the Vancouver sub-regional land market to areas targeted for more intensive development is not possible unless county regulations are strengthened. The urban growth boundary, by state statute, is delineated on the basis of a projected twenty-year build-out. This boundary, though sufficient to protect most resource lands from urban conversion, is ineffective at promoting contiguous rather than leapfrog development within its limits. Indeed, speculation rises in fringe areas because of the uncertainty about precisely where and when sequential development will occur (Brown et al. 1981). If prospective development zones were clearly circumscribed around urban centers, land prices would incorporate their future urban value, while the excluded external sites would remain at their semi-rural use value.

Regulatory Issues

The following issues are raised briefly here with the aim of increasing the effectiveness of urban growth management in concert with land value taxation:

Concentric Holding Zones. Perhaps the most urgently needed requirement in the tool box of urban growth management is a mechanism to ensure contiguous, phased development emanating from established growth centers. Such a mechanism would define concentric holding zones beyond which new urban development activities (subdividing, construction, use conversion) would be restricted until a predetermined threshold ratio of developed area to total area had been exceeded. Upheld by the state's courts, a "tiered" growth control system is in effect in several New York State cities (Freilich 1992).

Large Lot Zoning. Clark County, for example, might consider abandoning large lot zoning designations, now regarded as temporary holding districts. Once the inefficient pattern of developing separate lots along county roads becomes established, the possibility of later replatting these sites within a planned urban street network is largely lost. Furthermore, land assessment practice should seriously consider the incorporation of lot sizes into comparable sales data. As a case in point, King County has adopted the assessment method of normalizing lot values on a square-footage basis. Under an LVT system, oversize residential lots would be subject to higher taxes commensurate with their potential return from land price inflation and their more extensive land use.

Land Banking. Land banking refers to the acquisition of land in advance of its intended development. The rationale for government purchase and holding of vacant parcels becomes more apparent when seen in the context of land value taxation. In some areas the market demand for permitted uses may not be maturing at the same pace that increases in the tax burden take effect. To avoid triggering premature development and forcing vacant land into low-intensity, undesirable uses through incentive taxation, a local public trust created for this purpose could offer a sale option to landowners.(4)

Major Facility Siting Provisions. Washington State in recent years has aggressively pursued economic development strategies that offer generous sales tax abatements to major employers, with no siting stipulations. Such extenuation is fraught with danger to wise land use practices, in that the impulse to minimize land purchase costs can lead to leapfrog patterns of development. The external costs of sprawl, including infrastructure expansion and commuting travel costs, constitute an enormous burden on employees and taxpayers (Tillett 1995). It would be desirable for comprehensive plans under GMA guidelines to contain a major facility siting provision, obliging firms receiving tax abatements to locate within planned urban centers, with priority given to existing centers.

Conclusion

Land value taxation appears to offer much better prospects for promoting efficient land use, dampening land price inflation, and discouraging land speculation than does the conventional property tax system. In the case of the rapidly growing Vancouver UGA, its potential for short-term results is currently limited by high increases in land values. Its potential for long-term results depends on both the effectiveness of regulatory devices to direct the location of new urban growth, and assessment practices that incorporate the unit value of sites.

In the state of Washington, a constitutional amendment would be required to allow counties the option of implementing differential rate taxation. The "uniformity clause" (Article 7, Section 1) provides that all taxes be uniform upon the same class of property, meaning that the land and improvements constituting all real estate must be taxed at the same rate. Despite this encumbrance, a coalition of Georgists and environmentalists continues to advance the proposition. The Association of Washington Cities adopted a resolution urging the

state legislature to look into a two-rate system as a means to promote central city revitalization and to help cities meet requirements under the Growth Management Act (Heller 1993).

Land value taxation as a growth management tool is not a cure-all. Further study of its consequences should address questions about its applicability to more distressed urban regions, and include dynamic effects on property values and investment decisions. Perhaps the initial step in a new approach to urban growth management is to embrace a more progressive system of property taxation. Doing this means, first, recognizing the distinction between what is privately generated value in real estate, and what in principle belongs to the community.

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AUTHOR'S NOTE

The author has completed a second study of land value taxation for the Lincoln Institute of Land Policy, in collaboration with Jim McIntire, Director of the Fiscal Policy Center, Institute of Public Policy & Management, University of Washington. That study further explores the effects of a two-rate tax on urban fringe and resource lands, as well as sub-regional equity issues.

NOTES

1. Leapfrog development, the first dimension of sprawl, is scattered, or noncontiguous, development. One practical measure of sprawl is the extent to which vacant parcels lie within a predominantly developed urban area. The primary data file obtained from the Clark County Department of Assessment shows that seventy-six square-mile sections lie wholly within the Vancouver urban growth boundary.

Comparing the numbers of vacant sites within geographic sub-areas with the numbers of developed sites yields an overall vacant site ratio of 10 percent. How the individual section ratios are distributed is the material indicator of leapfrog conditions. Rather than showing contiguous development emanating from the Vancouver center, the urban region has the look of a checkerboard pattern, with many adjoining sites skipped in favor of outlying sites, especially to the northeast. In some northeast sections more than 15 percent of the parcels remain undeveloped, while in several outer sections those ratios are under 7 percent. No doubt the siting of major new employment attractors in predominantly undeveloped areas is responsible for some of the leapfrog development.

The question might arise, what would the Vancouver urbanized area look like if recent development had occurred more contiguously, at the vacant site levels found in the center city? Using the vacant site ratio of 6 percent found within the 6-square-mile area surrounding the CBD, only 48 rather than 76 square miles would hold the current developed parcel capacity at the same net density levels.

The second dimension of urban sprawl, low-density development, has already been described in terms of land consumption patterns. During the 1990-1995 growth period, about half of the residential land area developed in Clark County was sited on lots zoned as medium (7,000 to 10,000 square feet) and large (10,000 to 40,000 square feet). By way of contrast, typical in-city lots average 5,000 to 7,000 square feet. In the 1995 assessment data, large-lot parcels, averaging over 38,000 square feet, comprise nearly a quarter of the inventory of single-family developed properties. As many as ten of the seventy-six square mile-sections within the UGA contain a majority of large-lot parcels, several of which are located midway between the CBD and the urban growth boundary.

2. The Department of Assessment's data file does not contain lot and building areas for all properties. Only 73 percent of the commercial property listings, representing less than half the total commercial assessed value, contain this information, whereas 97 percent of the single-family, residential parcel listings record square footage. Since residential properties make up an overwhelming proportion of the total parcel count, the results of an analysis on residential properties should be broadly applicable.

3. Just how significant this apparent divergence is can be determined by constructing a hypothetical distribution of the two quotients based on the overall relationship. If the BLRs were consistently seventeen times the FAILs in all residential categories, new hypothetical BLRs would be attained that corresponded precisely with the physical measure of land utilization. In this instance the new site ratios corresponding to the large-lot category would drop from 1.93 to 1.04, and small-lot site ratios would increase. (See table 1.) This group of large-lot properties would now see a jump in total assessed land value from $ 601 million to $ 2,136 million, as the grand total assessment remained the same. This difference amounts to an additional $ 123,871 added to the current average land assessment of each large-lot parcel, resulting in an adjusted mean lot value of $ 177,550, which is commensurate with lot size and building utilization.

A sample of 969 single-family properties forming a major Vancouver UGA growth sector was drawn for the purpose of measuring the degree of association between calculated FARs and BLVs. The coefficient of correlation across individual parcels is .606.

4. based on comments offered by William J. Siembieda, Ph.D., former Director, Center for Research and Development, School of Architecture and Planning, The University of New Mexico, Albuquerque, NM, October, 1995.

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Gihring is a Seattle-based consultant in housing program development and neighborhood planning. He previously taught graduate urban planning and managed international planning and development projects.
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BODY:

BASIC STATISTICS OF DENMARK

THE LAND

Area (1 000 sq. km) 43

Agricultural area (1 000 sq. km) (1994) 27

Inhabitants in major cities, 1.1.1998 (thousands):

Copenhagen 488 Arhus

282 Odense

184 Alborg

161

THE PEOPLE

Population, 1.1.1998, thousands 5 295

Number of inhabitants per sq. km 123

Net natural increase (average 1991-1997, thousands)

6

Net natural increase per 1 000 inhabitants, 1997

1.5

Civilian employment, 1997, thousands 2 649

By sector:

Agriculture 99 Industry

516 Construction

176 Market services

914 Community, social and personal services

921 Other 22

PRODUCTION

Gross domestic product in 1997 (Kr billion):

1 122.98

GDP per head (1997 US$) 32 144

Gross fixed capital formation in 1997 (Kr billion):

225.3

Per cent of GDP 20.1

Per head (US$) 6 443

THE GOVERNMENT

Public consumption in 1997 (percentage of GDP)

25.3

General government current revenue in 1997 (percentage of GDP)

56.7

Public gross fixed capital investment in 1997 (percentage of GDP)

1.9

Last general elections: 11.03.1998

Composition of Parliament (number of seats):

Social Democrats 64 Liberals

43 Conservatives

17 People's Socialists

13 Danish People's Party

13 Centre Democrats 8 Social Liberals 7 Left Alliance

5 Christian Democrats

4 Progressive Party

4 Independent

1

Total 179

Next general election: 11.03.2002 (at the latest)

FOREIGN TRADE

Exports of goods and services as percentage of GDP, 1997

36.0

Main exports in 1997, percentage of total merchandise exports:

Agricultural products 14.7 Crude materials, mineral products, oil 7.7 Chemical and related products 10.9 Machinery and instruments

25.9 Other manufactured products

28.8 Other products

12.0

Imports of goods and services as percentage of GDP, 1997

32.6

Main imports in 1997, percentage of total merchandise imports:

Intermediate goods for agriculture 2.8 Intermediate goods for other sectors 43.3 Fuels and lubricants 4.9 Capital goods

12.2 Transport equipment

7.3 Consumer goods

30.3

THE CURRENCY

Monetary unit: Krone

Currency units per US$, average of daily figures:

Year 1997 6.604 October 1998 6.227

Note: An international comparison of certain basic statistics is given in an Annex table.

Assessment and recommendations

Overview of current policy issues

The expansion, now five years old, has been characterised by strong employment growth and falling structural unemployment. Inflation has remained close to 2 per cent and interest rates have converged to core EU levels in response to exchange-rate stability and a return to budget balance. However, domestic demand growth has substantially exceeded the 3 per cent projected when Denmark was last reviewed in April 1997, and has outstripped supply potential, prompting a series of fiscal packages to reduce personal consumption. The 1994-96 labour market reforms have enhanced the supply potential of the economy, but their impact on structural unemployment is now close to being complete, and the scope for further increases in potential output depends upon raising the labour supply in the face of a rather high burden of taxes and transfers. With productivity growth slowing and international competitiveness weakening, economic policies thus face the challenge of translating recent good economic performance and achievement of social goals into balanced, longer-run growth. Against this background, the Survey begins by assessing demand and supply prospects up to 2000 in the context of recent stabilisation initiatives (chapter I). The monetary and fiscal background is examined in chapter II in the light of Denmark's opt-out from the EMU and the need for better control over spending programmes, especially on the part of the local authorities. Chapter III assesses progress in structural reform, from the perspective of the recommendations given in the OECD Jobs Strategy and the follow-up in the 1997 Economic Survey of Denmark. The in-depth structural chapter is devoted to the housing market, which is

crucial to understanding Danish business cycle behaviour over the past three decades, and has important implications both for efficient resource use and the outcome of distributive policies.

Unsustainably high growth in domestic demand has had to be slowed

The rapid pace of economic growth in 1997 derived from accelerating domestic demand, while import growth outpaced exports. Falling long-term interest rates and rising asset prices, particularly in the housing market, fed into household demand, prompting a series of fiscal measures from the spring of 1997 to slow housing demand and spending on consumer durables. Output began to slow in early 1998, as import penetration increased and exports weakened in response to declining market growth and significant losses in market shares. However, the growth of domestic demand remained unsustainably high, at 4 per cent year-on-year in the first half of 1998, prompting further fiscal measures to stabilise house prices and stimulate household savings. With public sector demand also being reined in, domestic demand growth should slow from an estimated 3 per cent in 1998 to around 2 per cent over the next two years. GDP growth may be around 2 per cent both for 1998 as a whole and in 1999-2000, with the current account remaining in moderate deficit.

Employment and inflation performance are good, but the tight labour market is a threat to competitiveness

From a supply-side perspective, the five-year upturn in the economy has exhibited significant strengths, but with some incipient weaknesses. The strong growth in employment-intensive services sectors has resulted in annual employment increases of 1 1/2 per cent or more in the past two years. At the same time, an expansion in the number of persons enrolled in active labour market policy programmes (ALMPs) or seeking early retirement has offset the usual cyclical rise in the labour supply, so that open unemployment has fallen to 6 1/2 per cent (corresponding to 5 per cent on internationally-standardised definitions). Inflation has been relatively stable, as wages have responded only slowly to a steadily tightening labour market. However, productivity growth has weakened considerably during the expansion and wage growth in the core labour market has remained above that in Denmark's main trading partners. Unit labour cost increases have therefore gradually impaired competitiveness. Although the economy is slowing, pressure on resources is likely to remain too high to prevent a further erosion of competitiveness and weak export growth, and in this respect growth could remain unbalanced. Indeed, with unit labour cost increases in the business sector projected to remain 2 percentage points above those in the EMU area, further macroeconomic and structural measures may be needed to ease pressure on resources.

Financial-market conditions are expansionary

The success of the fixed exchange rate strategy in achieving price stability and lower interest rates, noted in the last Survey, has been sustained during 1997 and 1998. The krone has adhered very closely to its central parity vis-a-vis the Deutschemark, while both short- and long-term interest rate differentials remained at 1/2 percentage point or lower until the turmoil in international markets in late summer. Danish long-term interest rates fell in parallel with European rates during late 1997 and into 1998, pushing bond yields in Denmark below 5 per cent in mid-1998. Financial market conditions have been more stimulatory in recent years than at any time during the 1990s. Insofar as Denmark has been ahead of Germany in the cycle, adopting the same monetary policy may have imparted an expansionary stimulus in excess of that warranted by domestic conditions. The credibility of the fixed exchange rate link has, however, averted the danger of rising inflation expectations and bond-market evidence suggests they may even have declined. While the absence of an independent monetary policy has placed the burden of macro-economic stabilisation on fiscal policy, the fixed exchange rate policy has thus, on the whole, served Denmark well in that it has provided a firm anchor for domestic price and wage expectations.

The new European monetary policy environment reinforces the need for discipline in Danish policymaking

The now well-established confidence of financial markets in the fixed exchange-rate strategy will be valuable when monetary arrangements change with the inception of the Economic and Monetary Union, of which Denmark has opted not to be a member. Danish securities are now increasingly held in foreign portfolios without offsetting hedging operations, but Denmark's position will be more exposed to shifts in international sentiment than would be the case with EMU membership. The successor institution to the ERM (the so-called ERM2), which establishes exchange rate co-operation between the euro and non-participating EU countries, will underpin Danish monetary policy with an explicit commitment to defend the chosen parity with interventions and credit arrangements - subject to Danish economic policies remaining consistent with price stability. In this respect, the Danish authorities and the European Central Bank have agreed to underpin the arrangement by defining a narrow fluctuation band of [+ or -] 2 1/4 per cent for the krone vis-a-vis the euro. The need to ensure that the risk premium in krone interest rates is minimised, places an added emphasis on maintaining a solid structural surplus in the public finances, as well as on further structural reforms to enhance economic growth.

Fiscal policy has been slow to react to the strong economic upturn

With the fixed-exchange rate commitment resulting in expansionary monetary conditions, fiscal policy has been actively used to balance demand during 1997 and 1998. However, the signals to which fiscal policy has reacted have been subject to the traditional recognition and implementation lags. The initial fiscal policy stimulus in 1993-94 has not been fully reversed, as activity and employment growth in the public sector have consistently overshot, with the result that fiscal restraint has had to be effected via action to slow household demand. The record of fiscal policy in recent years has thus tended, ex post, to be one of delayed implementation and insufficient expenditure control, bringing in its wake tax levels above those envisaged when the medium-term strategy was embarked upon.

... but fiscal consolidation has been substantial

Despite these qualifications, the record of fiscal consolidation in Denmark stands out internationally. Denmark was, in 1996, one of the first EU countries to satisfy the criteria under the "excessive-deficit" procedure applying to the first and second stages of the Economic and Monetary Union. The general government balance moved into surplus in 1997 and the debt-to-GDP ratio declined from about 80 per cent in 1993 to below 60 per cent in 1998. The new medium-term programme foresees a further increase in the budget surplus to an estimated 2 1/4 per cent of GDP in 1999 and 3 per cent in 2005. Fiscal consolidation has been helped by the strong recovery in domestic demand, which has made for buoyant tax revenues but which also implies that the surplus may be vulnerable to unexpected below-trend economic growth. A high tax level and cyclically-sensitive unemployment benefits still contribute to an above-average cyclical sensitivity in Danish public finances. Overall, however, provided deviations from the expected growth path are not large, the planned pace of consolidation should allow Denmark to meet both its obligations under the Stability and Growth Pact and prepare for longer-term demographic challenges.

Control over local government finances needs to be strengthened

According to the new medium-term programme, the growth of public consumption is to be limited to 1 per cent a year and the share of transfer recipients in the working-age population reduced from above 24 to about 19 1/2 per cent, allowing a reduction in the tax-to-GDP ratio of 2 percentage points. These goals are ambitious, and meeting them depends on better control of public expenditure. A number of steps have been taken to this effect during 1997 and 1998, with respect to both public consumption and transfers to households. The role of the local government sector is particularly critical, higher spending in this sector during the 1993-98 period having

been financed from higher taxes. Given that municipalities and counties set their own tax rates, central-local agreements have imposed inadequate constraints on municipalities and counties over the past five years. The agreement concluded for 1999 introduces a number of innovations to enhance control, including bonuses to reward lower tax rates. However, recent tax and expenditure data show that the agreement has again been broken, indicating that a more robust system with harder budget constraints is called for, embracing stronger incentives for municipalities and counties to critically review their expenditures and contain the tendency to higher taxes.

Transfer schemes have been modified, but disincentives remain strong

Total government transfers have fallen by 4 percentage points relative to GDP since their peak in 1993. Stricter eligibility and job-availability criteria, together with strong demand for labour, have resulted in unemployment benefits falling markedly and paid-leave schemes being reduced in scope. Other transfers to the working-age population have, however, not been reduced. In particular, the inflow into early retirement schemes has continued to rise. To stem the strong rise in transfer recipients, the Danish authorities have focused on reducing inflows into sickness benefits as a conduit to disability pensions and permanent labour market passivity. They have also encouraged more flexible job arrangements for older workers and those with below-average capacity for work, by offering wage subsidies and by leaning on the social partners to integrate such jobs into the wage bargaining process. These initiatives, albeit partial, are welcome. But the strategy fails to address the disincentives embodied in transfer schemes, which should be the main priority for action. These disincentives are internationally rather high and are generally most pronounced for low-paid workers, who gain very little by moving from unemployment to work and who often move from unemployment to early retirement. Improved incentives are needed for such individuals to remain in the labour force and compete successfully for jobs. In addition to a higher age for accessing early retirement benefits, the crucial elements needed here are lower replacement rates and wages which are more responsive to shifts in demand.

The 1998-2002 tax reform should serve to improve capital-and labour-market outcomes

The two tax reforms of 1987 and 1994 have broadened the tax base and lowered the marginal tax rates applying to interest payments from an average close to 60 per cent to a typical rate of 46 per cent in 1998. The reforms have prevented real after-tax interest rates from falling to zero or lower, thus helping to smooth the economic cycle. However, apart from the overall high tax level which implies high marginal effective tax rates for low-paid workers, the Danish tax system also displays weaknesses in capital income taxation. Against this background, changes in the tax system were adopted by Parliament in June 1998. Applying to the 1998-2002 period, the tax reform signifies another important step towards improving savings incentives, the tax value of deductible interest payments being lowered to an average of around 32 per cent. The reform also reduces anomalies in capital income taxation which have implied wide differences in tax rates depending on asset and ownership and hence room for tax arbitrage. It should thus make for a better functioning capital market. By shifting the tax base from taxes on labour to environmental externalities ("green taxes"), and concentrating rate reductions on the low-paid, the reform also contributes to ease distortions in the underperforming part of the Danish labour market. The remaining issues to be dealt with concern the high and unchanged marginal tax rate on positive capital incomes and a corporate tax rate above those in other Nordic countries.

Reform of active labour market policies and education is proceeding at a rapid pace

Structural reform in Denmark has been tightly organised with regular reports on progress made and issues outstanding. Progress is most pronounced in labour market policies proper, where the first two stages of reform have been implemented and the interface between social and labour market policies has been developed to

expose social assistance recipients to some of the same requirements as the insured unemployed. A new set of rules has now been adopted to ensure compliance with the overall objectives in the 2005 programme. They stipulate compulsory activation after only one year of unemployment (or six months for youths 25 years or younger, with or without a complete education), and a reduction from five to four years in the combined period of unemployment benefit and compulsory activation. They also strengthen the enforcement of job-availability requirements. Education and training of the unemployed are to be tailored more closely to employers' needs. These measures go in the right direction. However, the impact on structural unemployment would be greater if the aggregate unemployment benefit and compulsory activation period were reduced even further. Lowering state support to seasonal and highly cyclical industries through the unemployment insurance system, for instance by linking contributions to past use, and introducing replacement rates which decline over the unemployment spell would have an impact on labour-market outcomes without seriously compromising equity objectives. This would be especially true if human capital formation were to improve as a result of the recommendations emanating from the extensive quality review of the education system recently carried out by the Danish authorities.

Product-market competition has been sharpened, but reform of public utilities has to be more clearly defined

Competition in product markets has been sharpened with the implementation of the new competition act, which embodies the prohibition principle generally in use in the EU. This should help to break down resistance to structural change and improve resource use. However, the act does not override certain sector-specific laws, and further efforts should concentrate on reviewing the anti-competitive impact of these. Several steps have already been taken in this respect, the most recent being the telecommunications act, where the incumbent, although dominant, has seen its powers proscribed. This strategy has not yet been applied to the transport sector, where regulations impede the necessary restructuring in the rail network and prevent the development of long-distance bus services, thus restricting consumer choice. The energy sector is still heavily regulated, sheltering producers from both external and internal competition. A recent opening of the market can be seen only as a minimum solution to comply with requirements given by EU directives, and leaves Denmark out of step with its neighbours. A fully competitive framework would hold out the promise of significant benefits for households and industry.

Housing has played a central role in stabilisation, distribution, and resource-allocation policies

The housing market, which is the subject of the special chapter, has played an especially important role in Danish stabilisation and structural policies. The Danish housing market has been highly cyclical, with strong repercussions throughout the economy. House prices are very sensitive to changes in interest rates and taxes, and housing wealth has a stronger short-run effect on private consumption than in most OECD countries. Housing investment is also strongly cyclical. The sensitivity of housing demand to financing conditions has been exploited by governments for stimulating and cooling the economy. Housing demand has thus been an integral feature of the transmission mechanism by which fiscal policies are used to affect economic conditions. The fact that housing has been one of the main focuses of welfare policies has given rise to extensive budgetary commitments, as income redistribution objectives have led to an extension in means-tested housing benefits to 22 per cent of all households. At the same time, long-standing rent controls, together with preferential tax treatment and direct subsidies, have had severe implications for the efficient allocation of national resources. Rents based on historic construction and financing costs remove prices as the mechanism for market clearing, with allocation being based on queuing or acquisition of seniority rights. The ensuing rent differentials reduce housing and labour mobility as households stay on in low-rent high-quality apartments.

Investment in private rental housing is obstructed by regulations

Housing investment in Denmark, at 3 3/4 per cent of GDP, is now rather low internationally. This partly reflects the high standard of housing and the fact that costs facing owner-occupiers have been gradually aligned with other investment options. In general, property rights in this segment of the market provide important incentives to repair and maintenance. But rent controls in social and pre-1992 vintages of private rented housing cause significant inefficiencies and have adversely affected the supply of such housing. Maintenance and repair of the existing stock of private rental housing have suffered. Those investors bringing new rental property on the market in the past fifteen years have mainly been tax-privileged institutions such as pension funds and life-insurance companies. In consequence, responsibility has been shifted back to the political system, necessitating large outlays to renovate and modernise the old rental property stock. The urban renewal programme of the 1990s, amounting to DKr 18 billion, has committed close to DKr 11 to 12 billion of public funds at even more favourable financing and individual support conditions than available elsewhere in the housing sector.

... which impede mobility and perpetuate inequality

While income distribution concerns remain fundamental to housing strategy, some aspects of the policies pursued have produced outcomes contrary to those intended. Rent controls have led to a system where privileges once obtained can be passed on through barter and subletting rights in private rentals and via seniority and inherited membership in social housing. Moreover, controls have conferred substantial capital gains on owner-occupiers in the major metropolitan areas. The property rights available in owner-occupied housing have produced a segmentation of households, where high-income families have been leaving the rented segments in favour of owner-occupied housing, and low-income groups and those outside the labour market have been increasing their representation in the rented segments. Having been introduced to serve distributional aims, the individual housing benefit tends to reflect age as much as income.

Reform of the housing sector should focus on tax discrimination, subsidies and rent controls

The framework of Danish housing policy has remained remarkably constant over the past two decades, despite the evidence of its distorting effect on resource allocation and the unfocused impact on income distribution. There has, nevertheless, been increasing recognition of the need to clarify the objectives of government intervention, and to review the effectiveness of the broad and indiscriminate support schemes in use. Housing-market distortions in Denmark may not be worse than in many other QECD economies, but scope remains for initiatives which would add significantly to economic performance:

* Continue reform of the tax and transfer systems to improve resource allocation and improve equity: taxes and implicit subsidies for owner-occupied housing should be rebalanced to ensure a neutral tax treatment vis-a-vis financial investment. If desired, any differentiation between housing segments should be effected through direct subsidies, although in general "bricks and mortar" subsidies would no longer appear warranted and should be phased out. Housing support could then be provided through the individual housing benefit alone, provided it is reformulated to eliminate any intrinsic labour-market and savings disincentives.

* Modify the tax system to reduce the contribution of the housing market to macroeconomic instability: placing the taxation of housing income on a par with income from financial investments would reduce variations in household wealth caused by capital gains and losses and would serve to dampen the strong cyclicality evident in the owner-occupied housing market. (It would also need to apply to other segments to which property rights were extended.)

* Dismantle rent controls and extend property rights to improve mobility and maintenance: rent controls in social and private rented housing should be removed, allowing rents to reflect underlying differences in quality and preferences so as to stimulate maintenance and standard improvements. More generally, the introduction of extended property rights in social and co-operative housing, by allowing stakes in such housing to be freely traded, would allow these segments to compete on more equal terms with the owner-occupied segment for residents across all income brackets. As a particular urgency, cost control processes in urban renewal projects need to be improved, inter alia by requiring higher marginal financing from landlords and tenants.

* Continue the decentralisation process: if the strong attachment to public intervention in housing continues, consideration should be given to a further decentralisation of housing policies which allows municipalities to assess housing expenditure against other public priorities.

In sum, the longer-term outlook is good, but would gain from further reforms

Assessing recent Danish economic performance as a whole, it is evident that fiscal consolidation, monetary policy credibility and the structural reform programme have together been highly successful in creating the conditions for long-term growth. Resources are currently highly stretched and discretionary measures have been needed to prevent inflationary pressures from materialising. Achieving the high level of ambition set for policies of fiscal stabilisation now depends on whether and to what extent private saving reacts to reforms of the tax system. For the longer term, however, reforms to the tax system, to active labour market policies, of the education system and of the competition framework are working to raise the capacity for growth. If combined with action to remove the strong disincentives embodied in the wide array of transfers available to the working-age population, with further reform of public utilities and with measures to provide a more efficient framework for the housing market, the capacity to achieve both social and economic goals would be significantly enhanced.

I. Recent trends and prospects

Following four years of substantially above-potential growth, the Danish economy has begun to slow to a more sustainable pace. As has been the case throughout the expansion, domestic demand is still the driving force (Table I) and monetary conditions continue to be supportive. But fiscal policy has been tightened in order to engineer a "soft landing" from a position, in the first half of 1998, when domestic demand was expanding at nearly 4 per cent, and the labour market was tightening at a very rapid pace. A large-scale labour conflict erupted in the spring, affecting almost one-fifth of the labour market, and had to be resolved by government intervention. The final settlement limited the acceleration of wage inflation - which still remains low for an unemployment rate of just above 6 per [TABULAR DATA FOR TABLE 1 OMITTED] cent - but it included a reduction in working time which, if copied in other sectors, will be highly detrimental to the effective labour supply and hence potential growth. The inflation rate remained at around 2 per cent in 1998 [ILLUSTRATION FOR FIGURE 1 OMITTED] but lower import and raw material prices offset higher indirect taxes and declining productivity growth, and the stronger underlying inflation will gradually feed through to prices to consumers. Production has been subject to capacity constraints and increases in unit labour costs have continued to cause a deterioration in Danish competitiveness and exports continue to record significant losses in market share, at the same time as the negative effects from the Asian crisis are leading to a slowing of export market growth. While GDP growth should decelerate from nearly 3 1/2 per cent in 1997 to below 2 1/2 per cent in 1998 and further to about 2 per cent, in line with potential growth, in both 1999 and 2000, the prospects for sustainable, balanced growth depend quite heavily on whether recent fiscal actions have the desired effect of pushing up the rate of private saving and preventing the very tight labour market from creating additional inflationary pressure.

Demand and production: reducing excess demand

Private consumption growth accelerated to about 3 1/2 per cent in 1997 [ILLUSTRATION FOR FIGURE 2, PANEL A OMITTED], as the household saving ratio continued to fall. Financial conditions remained more stimulatory than at any time in the 1990s (see chapter II), and falling real interest rates added strength to the housing market rebound. The wealth effects of the real house price increases - since the beginning of the recovery in 1993 they have increased by more than half - may explain as much as about a third of the accumulated growth in private consumption. At the same time, the ratio between house prices and construction costs reached its highest level in the 1990s [ILLUSTRATION FOR FIGURE 2, PANEL B OMITTED], almost as high as in the boom years of the mid-1980s, which meant that houses were often cheaper to construct than to buy in the secondary market. Underpinned by strong income growth and low long term interest rates, housing investment thus grew at a rate of 9 per cent in 1997.

Experience from previous upturns suggests that in the absence of corrective action, house prices and consumption would probably have continued to expand rapidly, fuelled by rising asset prices and stimulatory financial-market conditions. Stabilisation efforts had thus to be directed at private demand. In May 1997, excise taxes on cars and transaction fees for house purchases were increased. Further action was taken in October 1997, increasing the negative demand impact of the 1998 budget by 1/4 percentage point of GDP. This action included cuts in government expenditure, a temporary compulsory pension contribution of 1 per cent of earnings, and steps to dampen turnover in the housing market by higher stamp duties on loan extensions ("borrowing against own equity"). However, with domestic demand growth continuing unabated and receiving further stimulus from falling long-term interest rates and lower oil prices, further stabilisation measures were needed in early 1998. The tax value of the deduction of interest payments was reduced, while tax privileges for individual pension savings were reduced in scope and the temporary pension contribution was made permanent. The main elements of this package (the "Whitsun package"), designed to raise the longer-run level of private savings, are being gradually phased in up to 2002. For its short-term stabilisation impact it relies on the traditionally strong capitalisation effects of lower tax deductions on house prices and consequent effects on housing investment and private consumption.

The adoption of the tax reform proposal in the early summer of 1998 has been followed by a substantial decline in consumer confidence, especially with respect to purchasing major household items. While the negative effect of the 1998 tax reform in lowering the value of the tax deductibility of interest payments has been partly countered by almost a full percentage point fall in long-term interest rates, the rise in house prices has nonetheless moderated, a minor fall being recorded in the third quarter of 1998. This should cut back the growth in housing investment to about 4 per cent, in addition to dampening the economy through strong wealth effects on private consumption (see chapter IV). The modest decline in the household saving ratio over the past couple of years has been arrested and it should register a slight increase for 1998 on average. However, personal spending continues to be supported by employment and real wage growth, as well as by historically low interest rates. In total, private consumption growth is expected to be 3 1/4 per cent in 1998.

Business fixed investment continued its strong growth in both 1997 and 1998, bringing the overall investment/GDP ratio close to its previous peak in 1986. Whereas in the early stages of the recovery business investments were mainly directed towards machinery, the high level of capacity utilisation [ILLUSTRATION FOR FIGURE 2, PANEL C OMITTED] has increasingly forced producers to expand capacity through investments in structures. On the other hand, overall construction investment is falling, owing to the termination of large infrastructure projects, such as the bridge over the Great Belt, connecting Zealand with Funen, while the activities related to the bridge across the Sound to Sweden are increasingly being scaled back and will be

terminated in the first years of the next century. In addition, investments in the North Sea oil fields are currently particularly high and are expected to be scaled back in 1999. Public investments have hardly increased since the beginning of 1997 as public spending on civil engineering projects and construction has been reined in to avoid overheating of the construction industry.

Manufacturing exports benefited from the acceleration of export market growth in 1997, but have faltered since the beginning of 1998 as the effects of the international slowdown in connection with the Asian crisis and subsequent financial turbulence have come through. The loss of export market shares for goods has continued with 3 1/4 per cent fall in 1997 (Table 2) and a further loss is estimated for 1998. The market share losses may be explained by deteriorating competitiveness, resulting from the strengthening of the nominal effective exchange rate since mid-1997 and the relatively fast growth in Danish unit labour costs. Since the start of 1997 wage growth has remained higher than Denmark's trade partners and labour productivity growth has slowed. An additional factor has been the faster domestic demand growth compared with its trading partners, encouraging Danish producers to serve the domestic market.(1)

Imports have been particularly responsive to the higher demand for investment and intermediate goods (Table 3), as well as to the demand impulses from private consumption. While energy imports continued to fall as a result of the increased self-reliance on energy production from the North Sea, there has been a worsening of the trade balance, particularly at the beginning of 1998 (Table 4). Together with higher outward transfers this has led to a steady worsening of the current account, which moved into deficit during 1998.

Table 2. Exports of goods and services

Percentage volume changes from previous period

1994 1995 1996 1997 1998

I(1)

Exports of goods 8.9 4.3 3.8 4.7 4.6

Of which:

Agricultural products 10.1 -2.6 -1.4 9.6 ..

Machinery and instruments 12.2 10.1 4.9 7.4 ..

Other manufactured goods 4.7 7.6 1.8 5.8 ..

Total manufactured goods 7.3 8.2 2.5 6.7 ..

Fuels and lubricants 26.5 -5.4 23.8 3.6 ..

Exports of services 7.8 5.9 11.8 1.4 -12.3

Total goods and services 8.6 48 6.1 3.7 -0.4

Manufactured products

Relative export prices 1.3 1.0 -0.3 -0.9 -2.4

Relative unit labour costs 48 7.1 -1.3 0.1 3.2

Export growth 7.7 8.8 3.0 3.3 7.5

Market growth 10.9 10.7 8.0 9.1 3.2

Export performance -2.9 -1.7 -4.6 -5.4 4.2

Memorandum item:

Export performance, total goods -1.4 -2.5 -4.3 -3.2 1.6

1. Seasonally-adjusted.

Source. Statistics Denmark OECD.

[TABULAR DATA FOR TABLE 3 OMITTED]

Table 4. The current account

DKr billion

1998

1994 1995 1996 1997 I

Trade balance 45.6 36.6 43.7 35.7 8.4

Non-factor services 10.6 10.9 10.6 0.5 -2.7

Net investment income -30.7 -27.0 -26.8 -21.1 -12.2

Unrequited transfers -8.5 -9.6 -9.8 -8.9 -2.9

Current account 17.0 10.8 17.7 6.1 -9.5

Memorandum item:

As a per cent of GDP 1.8 1.1 1.7 0.5 -1.6

Source: Danmarks Nationalbank: OECD

A tighter labour market but stable inflation

The economic recovery has been underpinned by a strong supply response in the manufacturing and construction sectors as well as in private services (Table 5). As the cycle has matured, growth has been characterised by a [TABULAR DATA FOR TABLE 5 OMITTED] slowdown of productivity and stronger employment growth, which has been as high as 2 per cent in 1998 in spite of the weakening of demand. It has been broadly based, resulting in somewhat faster declines in unemployment among unskilled and female workers than among skilled and white-collar workers [ILLUSTRATION FOR FIGURE 3, PANEL A OMITTED]. In sectoral terms, employment growth reflects the domestically-driven economic upswing, with equally strong growth in public and private employment. The latter has been dominated by the private service and construction sectors, while manufacturing employment has been practically flat. Of the around 100 000 new jobs created in 1997 and 1998, about one-third have been in the public sector and about two-thirds in the private service industries.

The labour supply expanded strongly in 1997 and has continued to grow at a moderate pace in 1998, although it has only reached the same level as at the start of the upturn in 1994. The recent enlargement of the labour supply - in addition to being a normal business cycle response - is the result of terminating the early withdrawal scheme for long-term unemployed, which has reduced the number of participants so far by about 10 per cent [ILLUSTRATION FOR FIGURE 3, PANEL B OMITTED]. Lower benefits and stricter eligibility rules have also reduced the number of participants in leave schemes by almost a half compared with the peak in 1995. On the other hand, the flow into early retirement schemes has increased from 6 1/2 per cent in 1997 to about 8

per cent in 1998. Despite the maturity of the economic recovery, participation in active labour-market schemes, early withdrawal and early retirement schemes remains very high, the total of 300 000 (10 1/2 per cent relative to the labour force) being only 8 000 less than at the peak at the beginning of 1996. As a result, registered unemployment fell about 25 000 in 1997 and by a further estimated 35 000 in 1998, bringing the registered unemployment rate towards 6 1/4 per cent by late-1998.

Wage growth is expected to increase mildly to just above 4 per cent in 1998, despite a rapid fall in the registered unemployment rate [ILLUSTRATION FOR FIGURE 3, PANEL C OMITTED]. The economy's ability to maintain wage inflation at a stable rate should be viewed against the range of labour-market reforms implemented in the 1993-98 period, which have undoubtedly served to lower the structural unemployment rate. Also, most of the employment growth has taken place in the public and private service sectors and outside the traditional wage leader sectors, manufacturing and construction. However, signs of a very tight labour market are emerging. In the spring the negotiated wage settlement between the Danish Employers Confederation (DA) and the Danish Confederation of Trade Unions (LO) was rejected in a union ballot, bringing almost 20 per cent of the labour market out on strike. The conflict was resolved through government intervention by passing a law which added more holidays and an extension of parents' leave during child sickness to the already-negotiated outcome. The implied increase in labour costs was neutralised by a lowering of agreed increases in pension contribution rates and by revoking an employer's refund to the sickness benefit scheme.(2) While only applying to the LQ/DA segment, an extension to other segments of the labour market would add further to pressures in an already tight labour market. Adding further to overall labour costs, the government has imposed higher social security contributions, amounting to another 1/4 percentage point increase in 1998, although these will be reversed in 1999.

Consumer price inflation has been hovering around the 2 per cent mark since mid-1994 [ILLUSTRATION FOR FIGURE 4, PANEL A OMITTED]. In 1998, indirect tax increases - in particular on energy - are adding about 1/4 percentage point to consumer price inflation, but this should not prevent a deceleration in annual inflation to just below 2 per cent, as lower oil and commodity prices, together with a 7 per cent strengthening of the nominal effective exchange rate since mid-1997, have reduced import prices [ILLUSTRATION FOR FIGURE 4, PANEL B OMITTED]. In terms of underlying trends, a cyclical slowdown of productivity and emerging inflationary pressures from a tightening labour market have tended to manifest themselves in higher inflation compared with the OECD average since the latter part of 1006 [ILLUSTRATION FOR FIGURE 4, PANEL C OMITTED].

The short-term outlook

Economic policy assumptions and the external environment

Fiscal policy is expected to continue to be mildly restrictive (a negative impact on demand of about half of a per cent) in 1999 as the combined result of the tax reform and the different fiscal tightening packages (Table 6). The fiscal bill for 1999 incorporates an agreement with the local government sector which, on the evidence of budgets presented, will not be implemented as envisaged but nevertheless serves to lower expenditure growth in 1999. In the absence of any policy announcement, a broadly-neutral stance is assumed in 2000. The effective exchange rate having stabilised after the appreciation in mid-1998, monetary conditions should continue to support growth, although the fall in long-term interest rates has come to an end. However, given the relatively fast unit labour cost growth in Denmark compared to its trading partners, the current strength of the nominal effective exchange rate for the kroner and capacity constraints in the manufacturing sector, Danish exporters are expected to continue to lose market shares. On top of this, the majority of Denmark's markets abroad have seen

growth prospects weaken and overall export market growth is expected to halve over the period 1997-99, bringing it down to just above 4 per cent.

[TABULAR DATA FOR TABLE 6 OMITTED]

Short-term outlook and risks

The configuration of demand and supply is expected to remain basically unchanged (Table 7), although households are expected to rein in their spending as a response to the improved saving incentives. However, with employment prospects remaining positive and substantial real wage increases still to come, households' real disposable income should increase sufficiently to allow both a rise in the household saving rate and an expansion of private consumption of the order of 2 per cent in 1999 and 1 1/2 per cent in 2000. Housing investment may still see positive growth rates and business investment growth is projected to remain robust in the face of unfavourable wage cost developments. Import growth will continue to outpace exports and the foreign contribution to growth will remain negative. Overall GDP growth should stabilise at around 2 per cent, near to potential growth, over the remainder of the forecast horizon. With employment growth projected at just below 1 per cent in 1999 and one-third of a per cent in 2000, unemployment should fall further below the NAWRU, the economy thus remaining at full capacity with resources highly stretched.

Table 7. Short-term outlook

Percentage change from previous year(1)

	1997	1998	1999	2000
Private consumption	3.6	3.2	2.1	1.5
Government consumption	2.2	2.1	1.5	1.0
Gross fixed investment	10.4	4.4	3.9	3.5
Business	12.0	6.1	4.4	4.0
Housing	8.8	4.0	3.0	2.0
Government	2.4	-8.4	2.0	2.0
Final domestic demand	4.7	3.2	2.4	1.8
Change in stockbuilding(2)	-0.2	0.1	0.0	0.0
Total domestic demand	4.5	3.3	2.4	1.8
Foreign balance(2)	-1.0	-0.8	-0.3	0.1
Exports of goods and services	4.3	1.7	2.0	3.4
Imports of goods and services	7.6	3.9	3.0	3.3
Gross domestic product (market prices)	3.3	2.4	2.0	1.9
Private consumption deflator	2.2	1.9	2.5	3.0
GDP price deflator	1.9	1.6	2.7	3.3
Household savings ratio	4.4	6.0	5.1	5.1
Current account, per cent of GDP	0.5	-1.0	-1.0	-0.9

Total employment 2.3 1.8 0.9 0.4

Labour force 1.2 0.5 0.4 0.2

Unemployment rate(3) 7.7 6.5 6.0 5.9

1. From 1998 onwards OECD projections.

2. As a per cent of GDP in the previous year

3. Level per cent of labour force

Source: OECD

Apart from the international environment, the main risks to the projection revolve around a possibly worse export performance than projected, stronger-than-anticipated inflation pressures and faster-than-expected growth in domestic demand. The current high cost level may be harmful for Danish exporters during a period when export market growth is decelerating, leading to larger-than-anticipated losses in market shares and a weaker current account. It could also hurt business investment and employment prospects. If the recently proposed labour-market reforms prove to be less effective in increasing labour-market flexibility than the 1994-96 reforms, the low level of cyclical unemployment may produce higher wage costs which would harm Danish export performance and widen the interest differentials vis-a-vis euro rates. The need for further fiscal as well as structural action should be seen primarily against the background that wage growth could remain unresponsive to the slowing of economic growth and a more competitive climate for Danish producers. On the other hand, product markets have become more competitive in line with the implementation of the internal market and this should act to restrain consumer price inflation. Furthermore, some uncertainty attaches to the effects of the recent tax reform. This has lowered the tax deductibility of interest payments, and could put a stronger-than-expected downward pressure on real house prices with adverse effects on private consumption. Such a scenario would stabilise inflation, but have adverse effects on public finances in the form of lower tax revenues and higher benefit transfers.

II. Macroeconomic policies

Economic policies were given a medium-term setting with the 1993-98 economic programme, which incorporated a fiscal impulse to boost short-term activity, a subsequent reversal to bring public finances back into surplus and a wide range of initiatives to raise the long-term growth of the economy. This programme has run its course, resulting in an improvement of the labour market and public finances well in line with objectives set. Combining short-term stabilisation and long-term structural objectives, the new medium-term programme extends the horizon to 2005, by which time demographic developments will start to bear heavily on public finances. More immediately, the setting of macroeconomic policies will change as Denmark's former ERM partners form an economic and monetary union in which Denmark intends not to take part, but to which it intends to establish unique ties. The present chapter examines the credibility obtained by the long-standing commitment to fixed exchange rates in such a perspective and the challenges facing fiscal policy, in view of the experience of recent years and in relation to objectives set.

Monetary policy

Implementing the exchange rate strategy

Since the turbulence in foreign-exchange markets in August 1993, when the narrow bands of the ERM were abandoned and a wider band of [+ or -]15 per cent introduced, Denmark has defined exchange-rate stability in terms of the bilateral exchange rates vis-a-vis "core" ERM currencies. This group of countries comprises

Germany, France, the Netherlands, Belgium, Luxembourg and Austria, and has seen very small divergencies in bilateral rates. In the Danish case, fairly high short-term interest rates were initially required to maintain stability, at an exchange rate somewhat weaker than the central parities [ILLUSTRATION FOR FIGURE 5 OMITTED]. But through 1996 a lowering of the short-term interest rate differential towards Germany, the dominant anchor country of the ERM, proved compatible with a gradual appreciation of the Danish krone towards its central ERM parity versus the Deutschemark. This parity was reached in early 1997 and has since been strictly adhered to, the deviations from it remaining less than 1/2 percentage point.(3)

Short-term interest rates remained practically unchanged through the first three quarters of 1997, but Denmark followed other ERM countries in increasing the deposit rate for banks (the discount), the key signal rate, by 1/4 percentage point in early October 1997. A period of substantial inflow of foreign exchange came to an end in late 1997, and was partially reversed in the spring of 1998. Market sentiment proved weak as the run-up to the May referendum on the revision of EU treaties contained in the Amsterdam Treaty coincided with the labour-market conflict, and an increase in the deposit rate of 1/2 percentage point in early May was necessary to stabilise currency flows. This unilateral Danish increase was partially reversed in late May, leaving short-term market rates at around 4 per cent, 1/2 percentage point above the German level. The impact of the short-term disturbances in international markets in August arising from the depreciation of the rouble and the depreciation of the Norwegian and Swedish currencies was handled effectively by unsterilised interventions to support the krone, which drained the money market of liquidity, thereby forcing an increase in interest rates of 1 1/4 percentage points or more for maturities below one month without raising key signal rates. For a time, short-term rates at about 4 1/2 to 5 per cent proved necessary to balance the foreign exchange market and the deposit rate was accordingly raised by 1/2 percentage point to 4 1/4 per cent in mid-September, accompanied by an increase in the width of the band between the deposit and the repo rate, before being lowered to 4 per cent in early November. However, as a consequence of the rapid and strong response, the krone exchange rate vis-a-vis the central European currencies remained stable throughout this period.

Monetary policy credibility

Trends in the bond market have largely mirrored those in the money and foreign exchange markets, Danish developments being closely aligned with those of the core ERM countries. Yields on 10-year government bonds fell below 7 per cent in late 1996, below 6 per cent about a year later and reached the 5 per cent mark in mid-1998. In the process, differentials vis-a-vis the other core ERM countries narrowed from 3/4 to 1 percentage point to less than 1/4 percentage point. More recently, the turbulence in international financial markets in the autumn of 1998 affected Denmark more than the EMU entrants, the interest rate differential temporarily widening to above 3/4 percentage point vis-a-vis Germany and around 1/2 percentage point against the others before again declining somewhat ([ILLUSTRATION FOR FIGURE 6 OMITTED], panels A to C). With the increase in money-market rates feeding into bond yields at very short maturities, which have remained fairly stable over the last year, the yield curve has again become rather flat (panel D).

Capital inflows have been strong in recent years, the rate of foreigners' net acquisitions of Danish bonds more than doubling over a couple of years. While acquisitions of government bonds were, to a large degree, hedged in forward markets in the early 1990s to offset the foreign-exchange risk, foreigners' willingness to hold open positions in Danish currency has increased sharply since 1994, with the high degree of stability vis-a-vis the central parity of the ERM grid. Foreign net debt has remained broadly unchanged at about DKr 250 billion (24 per cent of GDP by end-1997). At the same time, krone-denominated foreign debt, adjusted for non-residents net forward sale of kroner, has increased from DKr 200 billion at the end of 1994 to almost DKr 450 billion by the end of 1997 [ILLUSTRATION FOR FIGURE 7 OMITTED]. The conduct of Danish

monetary policy has thus gained in credibility, a factor which should contribute to a smooth transition into the regime operating from 1999, with the krone pegged to the euro.

Overall stance of policy

The fixed exchange-rate regime chosen by Denmark imposes a longer-run economic discipline similar to an inflation-targeting regime, since adopted inflation objectives in both have to be consistent with those of neighbouring countries and need to be strictly adhered to. Denmark has also adopted an inflation objective of 2 per cent, consistent with underlying monetary policy formulation in core ERM countries. However, unlike inflation targeting (as implemented by two of the other non-entrants, Sweden and the United Kingdom), which may entail an active role for monetary policy in stabilising the economy, a fixed exchange rate regime has to operate through a long-term disciplining effect on price and wage formation and fiscal policies, leaving any short-term stabilisation role to the latter, since the central bank will not be in a position to correct inappropriate wage and price outcomes. Assessing the extent to which such disciplining effects have become more pronounced is difficult, but some indicators are emerging: the rail in the yield curve across a broad range of maturities indicates future inflation rates which now seem consistent with price stability. While the assessment of real interest rates, as they are reflected in Danish indexed bonds, is subject to a high margin of error due to the particular tax treatment of their return compared with nominal bonds, developments over the recent year seem to indicate that the previous expectations of a flare-up of inflation a few years hence have subsided [ILLUSTRATION FOR FIGURE 8 OMITTED].

International confidence in the fixed exchange-rate link to the Deutschemark means that Danish monetary and financial developments have principally reflected monetary conditions in the "core" ERM anchor countries and exchange-rate developments between the ERM area and other international currencies. Real short-term interest rates have been on a slightly rising trend since mid-1997, at a time when the real effective exchange rate has also been rising ([ILLUSTRATION FOR FIGURE 9 OMITTED], panels A and B). But real long-term interest rates have continued to fall and financial conditions broadly defined(4) have (as noted in chapter 1) remained expansionary (panel C). Domestic demand has also been underpinned by a strong expansion of the balance sheet of banks and mortgage institutes, with bank lending growing at annual rates of above 10 per cent through 1998 and mortgage institute lending expanding by around 8 per cent (Table 8). In the absence of the corrective action through modification of the tax system just implemented, house prices and consumption would probably have continued to expand strongly for still some time.

Table 8. Money and credit

Percentage year-on-year changes, end of period

	1996	1997	1998 Q1	1998 Q2	1998 Q3
Money stock	7.2	5.2	6.2	3.7	8.4
Bank lending					
Total(1)	6.8	9.9	8.7	9.7	15.3
Businesses	7.6	8.3	10.2	9.6	19.4
Non-businesses	6.9	8.8	6.8	10.0	9.4

Mortgage lending 5.1 6.8 8.5 8.7 7.8

1. Resident banks' lending to domestic sectors

Source: Danmarks Nationalbank.

Adapting to a different European monetary policy environment

Under the Edinburgh agreement of December 1992, Denmark will not enter the third stage of the Economic and Monetary Union, thereby standing outside the single currency and the common monetary policy of the EMU after 1 January 1999. It retains an option to join the EMU but this right will only be exercised if accepted in a referendum. The European Council in Amsterdam in June 1997 laid down the criteria for exchange rate co-operation between central banks of EU countries outside the euro area and the European Central Bank (ECB) from 1 January 1999, the ERM2, which takes on particular significance for Denmark. It will be the only EU country which on present signals may be expected to maintain such an arrangement. (Greece which will enter the ERM2 at the same time as Denmark, is explicitly committed to EMU participation once it satisfies the convergence criteria required, while the United Kingdom and Sweden will retain inflation targeting.) While the institutional arrangements underpinning Denmark's fixed exchange-rate regime remain fundamentally the same, the changes in the European monetary policy environment imply a special status for Denmark in European financial markets. In ERM2, the Danish krone will cease to be one of several smaller currency jurisdictions attached to the ERM, underlining its position as a minor currency. While this may allow the krone to be used for diversification in international portfolios, it may also be more exposed during turbulence in foreign-exchange markets. This raises issues with respect to possible further steps which could serve to underpin the Danish regime.

The exchange rate co-operation embedded in the ERM2 retains in full present ERM arrangements for ensuring that fluctuation margins are kept: there will be automatic and unlimited interventions at the margin to support the bands, subject to fiscal, monetary and structural policies being conducive to price stability and economic convergence in the country concerned and to the maintenance of price stability throughout the euro area; and there will be credit arrangements to finance such interventions. The central monetary policy choice to be made is the width of fluctuation band. Denmark was a strong supporter of the narrow bands of the ERM, seeing them as an important disciplining device on domestic policies, and regretted their abandonment in August 1993. Hence, reimposing a narrow fluctuation band serves to ensure continuity in Danish exchange-rate policy arrangements, and the Danish central bank, the Danish Minister of Economic Affairs, the Finance Ministers of euro countries and the European Central Bank (ECB) have agreed upon a band of [+ or -]2 1/4 per cent. This will require severe discipline in fiscal policy and wage formation.(5) Even so, by embodying a risk of future exchange rate adjustments to adjust to imbalances in the domestic economy, the opt-out from the third stage of EMU may be expected to incorporate an inflation and exchange rate premium in domestic interest rates. As the differential of 1/4 percentage point on long-term bonds in the first half of 1998 indicates, this premium may be fairly small, but it can be expected to be more vulnerable to shifts in financial markets perceptions as underlined by the increase in yield differentials in the second half of 1998.

Policy requirements of the fixed exchange-rate regime

As noted above, exposure to foreign-exchange market turbulence will be minimised if public finances continue to be in solid surplus and structural reforms are forthcoming to raise the supply potential of the economy. In such an environment, the Danish central bank appears to have substantial scope to use short-term interest rates actively to support the peg and intervention margins chosen. Financing of households (see further documentation in chapter IV) and business is generally conducted at long maturities and fixed interest rates,

serving to shield them from variations in short-term interest rates. As a corollary, monetary policy would be a less potent instrument in short-term demand management than in many other countries even if it were used for this purpose.(6)

Once the long-term requirements of policy-making are recognised, any currency peg, whether irreversible or supported by an exchange rate arrangement, requires a careful formulation of overall economic policies to maintain the economy on a stable growth path and to balance inflationary and deflationary pressures. Economic shocks may hit countries and regions in an asymmetric fashion and the effect of a monetary policy response may differ both in amplitude and time profile. In respect to the asymmetry issue, over the past two decades the economic cycle in Denmark has shown a weak or negative co-variation with Germany and other core ERM countries (Table 9). This may be attributed to asymmetries in economic shocks, an important case being the effects of German reunification, but equally likely to differences in economic policy responses and in price and wage formation.(7) During the 1990s, the Danish cycle has been desynchronised with the European cycle, and adopting the monetary policy stance of Europe has imparted an additional expansionary stimulus to the upturn which started in 1993. With domestic capacity stretched, the external sector has suffered, resulting in an unbalanced recovery. Structural policies have served to dampen the impact on wage and price formation, but in view of their slow-acting nature, the main burden for keeping the Danish economy in phase has rested with fiscal policies.

Monetary policy impulses are transmitted to economic activity through a variety of channels,(8) their impact depending on structures in labour, product and financial markets. Monetary impulses appear to affect GDP in Denmark more rapidly than in Germany - with the maximum impact in Denmark after six quarters compared with fifteen quarters in Germany. But at the same time, the amplitude is far larger in Germany than in Denmark.(9) From a forward-looking perspective, the issue is whether Danish economic and financial structures will evolve towards those of the EMU countries, implying that economic developments will become more synchronised and the appropriateness of European monetary policy will increase. A fully credible exchange-rate policy may contribute to this. Austria is a well-known case where the fixed exchange rate policy has clearly seen an alignment in structural developments as well as an increasing synchronisation with the German economic cycle.(10) Competition, financial-market and tax policies which promote integration with European markets would work to produce similar outcomes. Meanwhile, however, fiscal restraint will remain the key to returning the economy to a balanced growth path.

Table 9. Co-variation between GDP in Denmark and other European

countries(1)

	1961-69	1970-79	1980-88	1989-97
Germany	0.59	0.84	0.30	-0.14
Core ERM countries(2)	0.68	0.74	0.24	-0.01
EMU countries	0.56	0.70	0.15	-0.01
United Kingdom	0.13	0.65	0.53	0.67
Norway	0.23	0.42	0.43	0.85
Sweden	0.52	-0.08	0.45	0.59

1 Measured by the correlation coefficient between GDP growth rates.

2 Germany, France, the Netherlands, Belgium, Luxembourg and Austria.

Source: OECD

Fiscal policy

Denmark was, in 1996, one of the first EU countries to satisfy the criteria laid down in the "excessive-deficit procedure" applying to the first and second stage of the Economic and Monetary Union. Moreover, even though it has chosen to stay outside the single currency it will still be bound by the Stability Pact, which obliges all EU countries to avoid excessive budget deficits and prescribes how to restore budget balances after severe economic shocks (Box 1). The economic sanctions embodied in the pact do not apply to non-euro countries, but in any case the economic performance of Denmark makes it one of the best-performing countries of the European Union with respect to control of public finances, and ambitions have been raised even further with the Government's 2005 economic programme.

Implementing budgetary policy: adherence to objectives set

Budget implementation in 1997 was characterised by both expenditures and revenues coming in higher than projected, making for an outcome for the general government balance in line with the 1997 Budget projection of a surplus of 0.2 per cent of GDP (Table 10). On the expenditure side, the main trends were a significantly higher than anticipated growth in public consumption, largely offset by higher income taxes and indirect taxes, which were boosted by discretionary action to slow private consumption and housing investment (see below). The 1998 budget balance is also developing well in line with projections of a surplus of about 1 1/4 per cent of GDP. Again, government consumption is running above projections, but lower expenditures on transfers have been sufficient to offset this. The projected increase in the surplus in 1990, to 2 1/4 per cent of GDP, is predicated upon a slowing of expenditure growth with both public consumption and transfers scheduled to decline relative to GDP.

Seen from a somewhat longer perspective and in terms of fiscal policy objectives, the results obtained have conformed closely to the fiscal framework set out in the mid-1990s. The convergence programme of 1994 envisaged a slight deterioration from the starting point of a 1993 general government deficit (at the time estimated) at 4 1/2 per cent of GDP, but from 1994 onwards deficits were planned to diminish as the fiscal boost was withdrawn and stronger activity spilled over into higher revenues and lower transfers. According to the programme, by 1998 the budget would be close to balance. In the event, the general government balance has improved by about 4 percentage points of GDP from 1993 to 1998, with public finances restored to balance in 1997 and a surplus of I per cent of GDP estimated for 1998 [ILLUSTRATION FOR FIGURE 10 OMITTED]. The improvement is due wholly to an elimination of fairly high deficits on the central government account. [TABULAR DATA FOR TABLE 10 OMITTED] Together with financial depositions which have reduced both government assets and liabilities, these trends have ensured a rapid reduction of public debt relative to GDP: gross public debt according to Maastricht definitions has fallen from around 80 per cent of GDP in 1993 to below 60 per cent by the end of 1998.

Overall, fiscal consolidation has benefited immensely from the strong recovery in domestic demand, which has made for buoyant tax revenues, which have been reinforced by the restraint effected through taxation; the strength of private and public services sectors has underpinned employment growth, which has not only benefited tax revenues but also allowed transfers to fall by close to 4 percentage points relative to GDP from their peak in 1993 and up to 1998 [ILLUSTRATION FOR FIGURE 11 OMITTED]. However, a high tax level and generous unemployment insurance benefits, combined with reliance on quantity adjustment in the labour

market, still make for above-average cyclical sensitivity of Danish public finances, making the surplus achieved potentially vulnerable to below-trend economic growth.

Fiscal policy as a stabilisation instrument

While fiscal consolidation has allowed an elimination of the budget deficit, the role of fiscal policy in stabilising economic activity has proved more problematic, due not only to the traditional recognition and implementation lags, but more generally to slippages in implementation of the annual budget ([ILLUSTRATION FOR FIGURE 12 OMITTED], panel A). Significant in this respect is the framework for keeping fiscal developments in line with macroeconomic prerequisites. Control of public expenditure has largely remained unsatisfactory, allowing public consumption to consistently expand beyond the room allocated (panel B). Over the past four to five years, fiscal policy has thus been characterised by stimulus from the expenditure side, only partially neutralised by tightening through taxation (panel C). This fully reflects developments in the local government sector, where taxes have typically been raised from 29.5 per cent in 1993 to 31.7 per cent in 1998 as a way of financing higher spending (panel D). Continued central government restraint has not been sufficient to offset these expansionary impulses. As a result, the initial fiscal policy stimulus in 1993-94 has still not been fully reversed.

As noted in the previous chapter, in 1997 personal consumption and residential investment were fuelled by falling interest rates and rising asset prices, prompting compensatory fiscal action. The May and August interventions aimed directly at cooling the housing market: transaction fees for house purchases were raised, higher stamp duties on loan extensions were introduced to dampen turnover and investment in social housing was again made subject to a quota arrangement. In conventional terms, the 1998 budget proposal of late August 1997 and the further measures introduced in October of that year incorporated a fiscal tightening amounting to 1/2 percentage point of GDP. When these measures proved insufficient to bring domestic demand growth down, action was taken in early 1998 to raise the level of private savings more permanently, as part of a tax reform (see below). The direct impact on economic activity is estimated to be close to zero both in 1998 and 1999, so that fiscal restraint emanates primarily from the induced effect of lower tax deductions on private savings and on house prices and hence on private demand.

With the benefit of hindsight, a tighter grip on public expenditures to avoid an overheating of the economy could have served to keep the economy on a more steady path during 1997 and 1998. Had the structural surplus been larger, corrective action could have been avoided, possibly allowing the 1998-2002 tax reform to be implemented via a lowering of the overall tax level, which would have kept the substitution effects desired but served to ease its acceptance and implementation. Such a formulation would have made for greater compliance with the objectives set out in the mid-1990s. At that time, the Convergence programme to the European Union in 1994 aimed for a reduction in expenditures relative to GDP of 12 percentage points from 1993 to 2000 and for taxes a decline of 4 percentage points. Expenditures are still some way off the target, a decline of 8 1/2 percentage points being in prospect up to 1999. For taxes, a reduction of 1 percentage point was recorded in 1994 and since then the tax level has been more or less constant around 49 1/2 per cent of GDP. Within a sound overall fiscal position, improving the structure of public finances should be given high priority in the years ahead.

Continued tax reform to improve economic incentives

Tax reform has been on the economic policy agenda since 1987, and the 1994-98 tax reform broadened the tax base to allow a lowering of marginal tax rates; it brought in proportional labour-market contributions and lowered the ceiling to marginal tax rates on labour (skatteloftet), and introduced environmentally-motivated

("green") taxes on a wider scale. Even after the reform, the Danish tax system has still contained a number of weaknesses: i) marginal tax rates on household capital income are higher in Denmark than in most other countries with consequent disincentives to savings, implying that the base-broadening cum rate-reduction approach could be taken further; ii) the standard corporate tax rate is also higher than in other Nordic countries; and iii) there is a wide disparity in the tax treatment of capital income depending on type of assets and also their ownership. The motivation for further reform has also included the need for a further shift of the tax base from labour income to environmental externalities, for an improvement in the labour-market incentives of low-paid workers, and for a better formulation of the taxation of real estate. Consequently, in a reform gradually phasing in changes up to 2002, the tax value of the deduction of interest payments is to be reduced. Additional reductions in tax rates are directed at low incomes from labour (treated in more detail in chapter III). Moreover, tax privileges for individual pension savings (kapitalpension) are to be reduced in scope. The main elements of the reform are described in Box 2.

With the reform, the Danish authorities will have made substantial progress in making the tax system more neutral between different modes of savings, both real versus financial savings and direct financial investment in bonds and shares versus investments through pension funds or life-insurance companies. In the process opportunities for arbitrage will be reduced. The reform process has been highly influenced by considerations relating to the different savings incentives faced by persons with positive and negative capital income. For both, lower tax rates will increase the incentives to save via "substitution" effects; but for those with positive capital income disposable incomes will rise, offsetting the substitution effect. The consequence of differentiating tax rates on the basis of the sign of net capital income is to face economic agents with quite different prices of capital - in opposition to the principle of uniform taxation of capital underlying the dual income taxation model which Denmark was the first country to introduce. The net debt position of most tax payers will be less pronounced and some will move to a net asset position as a result of the improved savings incentives and the phasing out of the tax privileges of institutional investors. But with the highest marginal tax rate of 58.7 per cent facing households in a net asset position, tax-motivated arbitrage will still be highly profitable, taking account of the fact that investments in pension funds face a tax rate of 26 per cent. Such asymmetries will need to be addressed sooner or later.

Improving the control of public expenditure

Fiscal objectives in a medium-term setting

The Government presented its "Denmark 2005" programme in the spring of 1997 and its first annual update in mid-1998,(11) setting out the overall macroeconomic and fiscal objectives to be achieved by 2005. The focus is on mobilising the potential for continued employment growth, which will feed into continued surpluses in public finances and a reduction of both government and external debt. The aim is to create close to an annual average of 30 000 new jobs, corresponding to a growth rate of I per cent, and to reduce open unemployment to 5 per cent of the labour force. This is to be accomplished by a 160 000 reduction of transfer recipients, lowering their share of the working-age population from 24 1/4 to 19 1/2 per cent. The programme also builds in a reduction of the tax-to-GDP ratio by 2 percentage points over the programme period and a 1 per cent annual growth rate in public consumption. As a result, the surplus in general government finances is to rise from an estimated 2 1/4 per cent of GDP in 1999 to above 3 per cent in 2005, allowing the public debt-to-GDP ratio to fall below 40 per cent. Net external debt is expected to fall from its present level of 24 per cent of GDP below 10 per cent of GDP by 2005, reflecting the elimination of the current account surplus by 1998 which has made the original target of an elimination of the external debt by 2005 unobtainable without choking domestic activity.

In total, compared with the achievements in the 1994-1998 period, the programme is rather ambitious in its aim to rein in the growth in public consumption and reduce the number of transfer recipients.

Relations between central and local government

As noted in the 1997 Economic Survey of Denmark, fiscal restraint has been undermined by a consistent expansion in local government claims on resources, due to a ratcheting up of both expenditures and taxes. Relations between central and local government have therefore been under renewed scrutiny. Local government have significant devolved spending responsibilities and taxing powers, although they are generally allowed to borrow only for activities financed in full by user fees (see Box 3). There is an annual agreement based upon expenditure and revenue trends over the coming year, including local government tax rates, and block grants are adjusted each year for price and wage trends and changes in responsibility between central and local government. This system was, in the assessment of the Danish authorities, instrumental in ensuring a very subdued development in local government activity over the 1980s and even with the introduction of voluntary agreements in 1989, this trend continued up to 1992 [ILLUSTRATION FOR FIGURE 13 OMITTED]. Local government responded to the reorientation of economic policies in 1993 by allowing their activities to increase again, contravening agreements reached, and this expansion has proved difficult to rein in. While the annual agreements with municipalities during the 1993-97 period aimed for unchanged tax levels, the actual increase over those five years was 0.6 percentage points.

The central/local agreements are central to the philosophy of Danish policy-making, combining macroeconomic stabilisation objectives with local choice. Municipalities and counties have responded to local preferences and income levels by allowing local tax levels to vary by about 8 percentage points. However, the voluntary nature of the agreements - and the corresponding lack of sanctions - has implied a potential for a ratchet effect in local government activities, whereby taxes and expenditures rise when the economy is buoyant, but do not fall back in recession.(12) Tax competition between local entities has, at least in recent years, not been strong enough to offset this effect. Of equal importance in the Danish case has been the far from perfect understanding at central level that the extensive devolution and the annual budget agreement leave little scope for micro-managing sector developments. Decentralisation has made local government the chief provider in social services, health, and housing, either for free or at prices far below cost. Minimum standards are imposed by the central government, but otherwise local government has a large degree of discretion. As a result, local government has often been torn between the restrictions imposed by the annual agreement and the ambitions of sector ministries.

A recognition of these weaknesses underlies the agreement on the 1999 budget, which was preceded by a review(13) of the requirements of local government with respect to the goal set for public expenditure growth up to 2005. The review concluded that services could be maintained at a satisfactory level within an annual increase in public consumption of I per cent, provided that ambitions are jointly agreed and productivity increases provide the main source of standard improvements in public services. A number of innovations are thus contained in the 1999 agreements:(14)

* The horizon of the agreement is extended from one to four years with follow-ups at regular intervals and reporting through the budget year. based upon the review of their activities, activity levels and yardsticks for the quality of municipal services have been formulated. Activity beyond these limits have to be financed by user fees. As in earlier agreements, block grants will be adjusted to compensate local governments if revenue growth falls below the baseline consistent with the overall activity target.

* The agreements are based upon unchanged tax levels; with a bonus of 25 per cent for municipalities and counties which lower income tax rates(15) (an original proposal for a penalty of 25 per cent for tax increases, which would have been more efficient, having been withdrawn after consultations in Parliament) and co-financing of tax rebates to comply with the tax ceiling applying to personal income taxes following from municipal tax increases.

The 1999 agreements call for stronger co-ordination between the central ministries dealing with the local government sector, and implies several strong commitments from both parties. In its present format, the Danish system seeks to strike a balance between local choice on one hand, and central influence to preserve access to and equality of welfare state services on the other, and fitting this framework in with overall fiscal restraint has proved difficult. The agreements operate in an environment of equalisation schemes operating both on expenditure and revenues, and - with respect to social sector expenditures - a high co-financing with central government. Budgets for 1999 presented by local governments in late 1998 showed planned increases in tax rates and expenditure growth above those set out and in the past further slippage has tended to occur at the implementation stage. The present system of voluntary agreements is thus called into question. A first option to make the agreement stick would be to introduce a wide set of penalties, but it may well be asked if that would just serve to complicate the already highly-complex system. A rebalancing of the system in favour of local choice combined with a less soft budget constraint for local government, could make for a more stable system, if wedded to stronger requirements for charges and user fees to face communities with the cost of providing services. Public tenders and outsourcing would also be needed to ensure greater efficiency in their production.(16)

Reversing the trend in public transfers

Better control over local authority spending needs to be accompanied by measures to reduce the overall level of public spending. Denmark has the highest level of public consumption and one of the highest transfer levels among OECD countries, although the Danish practice of generally providing transfers gross-of-taxes should be borne in mind in cross-country comparisons. Transfers have risen continuously over the past 25 years. The increase in old-age pensioners has been fairly modest, at about 25 per cent (Table 11) and the associated outlay is limited by the fact that the pay-as-you go principle applies only to the basic flat-rate pension and the means-tested supplement. The fully-funded supplementary pension (ATP) and the system of labour-market pensions now being built up, [TABULAR DATA FOR TABLE 11 OMITTED] should ease the pressure on public finances when the elderly population again increases after 2005.(17) But more worrying from a public-finance perspective is the continuous rise in transfers to the working-age population, such recipients having increased from 10 per cent of the relevant population in 1970 to 28 per cent in 1996, the increase affecting all age groups above 25 years. As noted from a more detailed expose in chapter III, this rise should be seen from the background of a poorly-functioning labour market in the 1970s and 1980s. On the other hand, the build-up of transfer schemes is a significant part of the explanation of labour-market performance. In particular, labour supply is adversely affected as older workers use available opportunities to retire ahead of the formal retirement age of 67 years and as younger workers are found eligible for disability pensions (in the process the effective retirement age has fallen from 63 years in the early 1980s to 6172 years in 1997).

The redistributional impact of transfers is adversely affected by the fact that early retirement, although dominated by low-paid workers is spreading also to other categories, and that favourable treatment is provided to old-age pensioners through targeted subsidies and transfers regardless of the significant improvement of their relative incomes in recent decades. From a public finance and redistribution perspective, the challenge is to reduce unnecessary churning as people pay taxes and receive transfers, to relate eligibility for redistributive

schemes to earnings criteria rather than age, and to clarify the objectives of public transfer schemes in relation to private pension schemes now under expansion.(18) For the time being, public and private schemes seem to incorporate overlapping considerations which will pose pressing problems when the broad labour market pension schemes come to maturity.

Several steps have been taken and a variety of proposals have been ventilated in the domestic policy debate. The outflow from sickness benefits to permanent transfers has been strong and the municipalities are now required to investigate sickness spells above eight weeks, from which time they will also have to finance 50 per cent of the benefit (previously thirteen weeks). From 1992 municipalities have financed 50 per cent of disability pensions to persons below 60 years of age, and from 1997 that responsibility applies regardless of age. It has also been proposed to alter incentives further by lowering the central government refund and by making disability pension a transitory benefit for all but those with a total and permanent loss of work capacity.

But while the granting of sickness benefit and disability pension is the outcome of an administrative process in which parameters and practices may be changed, early retirement is dependent only on membership of a UI fund during a period of 20 years and has come to be regarded as an entitlement without scope for administrative discretion. Modifications have been introduced to motivate older workers to postpone their retirement from 60 to 63 years by raising the benefit then available but without much success so far. Access may be curtailed by raising the required years of work, a proposal which may restrict eligibility mainly to manual and clerical workers given the high graduation age from the tertiary education system and consequent short work careers of professionals. Such a proposal, as well as an unconditional increase in age required to access the scheme, may run counter to the general perception of an entitlement to which workers have adapted their labour market participation. Transition schemes to meet such considerations - often a feature of Danish policy making - may delay the desired public savings by a decade or more. Similar considerations would apply if a reduction of the stock of disability pensioners were to be accomplished by a review of all pensions granted rather than restricting the inflow.

The extensive involvement of the public sector in providing social insurance, often motivated by short-term labour market expedients rather than long-term considerations, seems to run counter to the need for further budget economy. Reversing the general upward trend in these schemes may require reforms going beyond the present - albeit well-warranted - emphasis on reform of administrative processes and tighter eligibility criteria. Most importantly, the decision to retire ahead of the formal retirement age should primarily be a matter for private-sector arrangements, of which the expanding labour market pensions would be a particularly suitable vehicle. Such a shifting of expenditure out of the public budget would serve to clarify decision-making in this area. Together with other efforts to increase efficiency in the provision of public services, this would set in train a process of gradually-falling tax levels.

III. Implementing structural reform: A review of progress

Introduction: implementing the OECD Jobs Strategy

OECD recommendations for Denmark with respect to implementing the OECD Jobs Strategy were grounded in the recognition that the Danish labour market already displayed a significant degree of flexibility, particularly with respect to the ability of enterprises to adjust employment to output. This flexibility has underpinned a relatively good labour market performance in recent years. At the same time, structural unemployment was seen as adversely affected by high marginal tax rates and replacement rates in unemployment insurance. The compression of wages at the lower end of the pay scale, combined with generous transfer schemes, has contributed to relatively high unemployment among low-skilled labour. Danish

unemployment thus displays a distinct educational profile, with the unemployment rate for those with only compulsory education twice the level of university and college graduates. It would also appear that labour market outcomes do not reflect the extensive resources committed to both formal and adult education, with skill acquisition unsatisfactory at lower levels of formal education and a very long school-to-work transition characterising upper secondary and tertiary education.

The OECD recommendations for dealing with these deficiencies were given against the background of significant changes in labour market policies already in the process of implementation. A tax reform programme phased in over the 1994-98 period has gradually lowered the tax wedge on labour. Paid-leave schemes have been made less generous; access to early withdrawal benefits for long-term unemployed (50 to 59 years of age) abolished; the duration of unemployment benefits reduced, and eligibility criteria tightened. A new emphasis has been placed on activating the unemployed, particularly youths with an incomplete education. The 1990s have also seen extensive educational reform in Denmark, as the education and training of the workforce have taken on pivotal roles in Danish economic policy. At the core of the reform lies the perception that upgrading the competencies of least-skilled workers may serve to validate the current level of minimum wages, avoiding the need to widen the dispersion of wage rates. While the Jobs Strategy also emphasises the critical role of education, the emphasis of Danish reforms differs from that of the OECD with respect to accepting the necessity for more adaptive wage structures as a complement to educational reform.

The first section of this chapter describes recent developments in the labour market, the results achieved so far and the problems that remain. The following section provides a description and appraisal of recent initiatives in the area of labour-market, education, and competition policies. The remaining challenges and agenda for completing the reform process are given in the final section of the chapter. The chapter draws upon the analyses and recommendations contained in the 1996 and 1997 Economic Surveys and recent documents of the Danish Government, notably the extensive benchmarking analyses and the 2005 programme, with its recent update and follow-ups in the labour market and education policy spheres.

Recent labour-market performance

The performance of the Danish economy has benefited markedly from the integration of structural policies into overall macroeconomic policies, and economic growth has been above that of its European neighbours for the fifth year running. Rapid economic growth has been accompanied by a strong improvement in labour market performance, employment increasing by more than 7 per cent since 1994. On national definitions, unemployment has fallen from above 12 per cent to 6 1/2 per cent, with a particularly strong fall in youth unemployment from above the national average (13 per cent) to below (5 per cent). Youths have responded to changes in economic incentives by seeking out ordinary jobs and completing their education, and this has clearly contributed to the more positive trend in this segment of the labour market. The overall improvement clearly reflects an elimination of cyclical slack, but structural unemployment can be estimated to have fallen by some 2 percentage points or more. This assessment largely reflects the observation that while nominal wage growth had picked up to 4 per cent at an early stage of the upturn - above what cost competitiveness considerations would warrant - it has nevertheless remained at that level for several years without any pronounced further pick-up,(19) in spite of rapid employment growth and falling unemployment.

The 1997 Survey noted that the results of reforms already made were encouragingly evident in the labour market for youths, where stricter eligibility rules for unemployed benefits had been effective in motivating a higher completion rate in vocational education and a more active search for non-subsidised jobs; but the trend towards early retirement for older workers was continuing, [TABULAR DATA FOR TABLE 12 OMITTED]

based on availability of government transfers. A resultant particularity of the Danish case is thus the stagnation of labour supply (Table 12), albeit at an internationally high level, in an environment which otherwise would be highly conducive to higher labour force participation. Leave schemes are being reduced in scope as take-up rates reflect the reduced generosity of paid-leave for child-minding and sabbaticals. But government intervention through a variety of early retirement, withdrawal and paid-leave schemes has continued to lower labour supply among older workers. Indeed, during the upturn, participation in such schemes and ALMPs relative to the labour force have increased from 9 to 10 per cent. At the other end of the age scale, the transition from compulsory education through further studies to labour-market participation is rather slow, in the assessment of the Danish authorities resulting in a permanent reduction of the labour force of around 3 per cent compared with a normal pass-through. A continued expansion of the economy is essentially dependent on an increase in the labour force to match future labour demand, whereas only a minor contribution can be expected from a further lowering of unemployment given the present formulation of transfer schemes.

Progress in structural reform

By the time of the first interim report of the follow-up of the OECD Jobs Study recommendations in 1997, it was evident that the impetus provided by the domestic reform programme made for a high degree of consistency between the official approach and the OECD recommendations, especially in the domain of labour market policies proper. The 1994-96 reforms were fully implemented by end-1998 but it is commonly accepted that their impact on structural unemployment is now close to being complete. The framework for continued reform to ensure a further rise in the growth potential of the economy has now been set out in the Government's 2005 programme(20) in which the recent tax reform has a pivotal role with respect to improving savings incentives, achieving a better allocation of capital and raising the supply of labour. On the structural reform side, the programme emphasises a reorientation of labour market policies, from the main priority of getting the unemployed back to work towards stronger efforts to reduce the premature withdrawal of older workers from the labour market and the outflow of younger workers to passive transfers. Underlying the programme is the emphasis given by the Danish authorities to short-term distributional concerns, which are seen as requiring rather high replacement rates in transfer schemes. The implication is that ensuing disincentives to job search should and can be offset by strict eligibility and job availability criteria, supported by the compulsory activation.

Reiterated in the National Action Plan for Employment submitted by the Danish Government to the European Union,(21) the programme aims for:

* A reorientation of the sickness benefit and disability pension schemes to ease recipients' reintegration in the labour market;

* More flexible job arrangements for older workers and those with below-average capacity for work;

* A reform of unemployment insurance to contribute to labour market flexibility;

* A further development of adult education with a view to strengthening its labour market relevance;

* Lower barriers for entrepreneurs and innovators;

* Stimulating business-financed research and development;

* A strengthening of primary education, a lowering of drop-out rates in upper secondary education to ensure that youths graduate with a vocationally qualifying education and a more rapid pass-through in the education system.

To detail these guidelines a more complete framework for the integration of labour market and social policies was presented in mid-1997(22) with consequent revisions to the Act on social services in mid-1998. This set the stage for a review of transfer schemes operating in the interface between the two policy areas as well as the preventive and reintegration work at work places in enterprises and the public sector. The foundations for further initiatives in education policy have been strengthened with a comprehensive quality evaluation; and competition authorities are moving on a broad front, following the final implementation of the new Competition Act from 1998 with extensive analyses of utilities' and private-sector markets.

Increasing wage and labour-cost flexibility

Aggregate wage growth has been rather steady in recent years. For the LO/DA area it approached 4 per cent at the end of the 1980s, fell to around 2 1/2 to 3 per cent at the trough of the economic cycle in 1992-93, but has until recently been around 4 per cent despite the significant turn-around in the labour market. Wage growth in neighbouring countries was relatively high in the early 1990s, so Denmark strengthened its competitive position, but with other countries experiencing falling wage growth, Danish competitiveness has again been weakening.(23) This apparent insensitivity to external forces, be it wage growth abroad or unemployment, may reflect a dualism in the Danish labour market, with a high degree of flexibility characterising the high-wage/high-productivity "core" segments comprising skilled blue-collar workers and those with a tertiary education. These segments, which have dominated wage bargaining for a long time, have been facing a far more stable labour market than unskilled workers.(24) Wage formation in these core segments reflects a) the low effective replacement rate in unemployment benefits at this level of earnings (often 60 per cent or lower); b) the flexibility which enterprises have to lay off workers, given in employment protection provisions basically decided by the social partners themselves, and c) the change in bargaining systems over the 1990s which embody a strong tendency for wage-setting to become a matter for local decision. Around 15 per cent of workers in the LO/DA area still have their wages decided in central agreements, and a similar share is subject only to local negotiations (Box 4).

The main impediment to wage and labour-cost flexibility thus seems to lie with the formulation of tax and benefit systems. The effects emanating from the bargaining structure relate, in part, to the signals given through centrally-negotiated wage increments, but more importantly to the role of central negotiations in agreeing working-time and pension arrangements, which are rarely set against wages paid in local settlements. With respect to aggregate wage growth, the gradual weakening in competitiveness has been the result of strongly expanding domestic demand, which brought the economy close to its potential. The ultimate test of the structural reform programme will lie in the capacity of the economy to transfer resources back to exports and import-competing activities and reduce wage growth to a more sustainable path when domestic demand growth slows.

The low-wage/low-productivity segment is more strongly affected by government interventions in the labour market, principally via the formulation of transfer schemes. The major determinants of reservation wages have - with one significant exception - remained unchanged in recent years. As noted in the 1997 Economic Survey, unemployed youths without vocationally qualifying education receive standard unemployment benefits for only half a year and will then have to transfer to activation or training schemes with benefits at half their initial value. With youths consequently seeking out education on their own or finding ordinary jobs, the effect on youth unemployment has been remarkable, and Denmark now has one of the lowest youth unemployment rates in the OECD. Similar reassessment effects of labour market prospects and reservation wages are aimed for with a tighter requirement for higher occupational mobility of the unemployed - obliging them to accept jobs

outside their former occupation after six months unemployment instead of twelve months - and with the compulsory activation which also aims at affecting job search behaviour.

For older workers, government efforts encompass attempts to make the social partners incorporate in their bargaining agreements jobs especially adapted to low-productivity workers threatened by structural change. In a far more limited scope, they also encompass job subsidies adapted to remaining work capacity. The efforts have met with some success and it has been estimated that wage agreements covering about half the labour market incorporate clauses to the above effect, whereas the extent of subsidised jobs (skanejobs or fleksjobs, the latter introduced 1 January 1998) at about 6 000 to 7 000 is developing as planned. Such policies nevertheless require close evaluation. It has been argued that Danish enterprises have been fairly good at adapting their work environment to workers at risk.(25) The problem is rather that existing government arrangements make it all too easy to transfer them to benefits. When the government now intervenes with an offer of subsidised jobs it may just substitute for what would have been forthcoming anyway.

Tax reform over the past ten to twelve years has been focused on lowering marginal tax rates, both for labour and capital income, with base broadening serving to ensure revenue-neutrality. These efforts have served to reduce disincentives to labour supply at the middle and the upper end of the income scale, but have been offset at the lower end: employees' labour market contributions introduced as part of the 1994-98 reform and presently at 8 per cent are proportional throughout the income scale and deductible in the bases for income taxes on labour income; more importantly, there has been a strong upward drift, as much as 6 percentage points over the past fifteen years, in local government tax rates, which are proportional above a basic allowance. Embodying an overall reduction of marginal tax rates by 2 percentage points for the majority of wage earners, the 1998-2002 tax reform is formulated to strengthen work incentives at the lower end insofar as the interval of incomes subject to only the lowest rate is extended by almost a quarter (from DKr 139 000 to 171 000 or from 50 to 65 per cent of the earnings of an average production worker). This will entail a reduction in marginal tax rates of 7 percentage points for a small category of workers with incomes just above maximum unemployment benefit, as opposed to the 2 percentage point reduction for all others [ILLUSTRATION FOR FIGURE 15 OMITTED]. Of equal importance for low-paid workers is the lowering of tapers in income-dependent subsidies for daycare of children, with the income interval over which they are phased out being doubled. This may lower effective marginal tax rates by 6 to 13 percentage points for lower incomes and increase them correspondingly for higher incomes.

Reducing distortions in unemployment insurance and related benefits

For the low-wage/low-productivity segment of the labour market, the replacement rate in unemployment benefits is 90 per cent, an effect compounded by the income-dependence of payments for day-care of children and housing benefits and by the fact that labour market contributions are levied on earnings from work but not on transfers. A survey among employed members of UI funds in 1996 indicates that 10 per cent have a lower income from work than they would receive if unemployed, a share which has increased from 7 per cent in a similar 1993/4 survey.(26) If incentives to work are deemed to be unsatisfactory if monthly incomes do not increase by at least DKr 500 when taking on a job, about 20 per cent of workers would fall in such a category, up from 17 per cent in the earlier survey.(27) While the surveys may be interpreted as indicating that the decision to work rests on far more than short-term financial considerations, and may point inter alia to the significance of tighter eligibility and job availability requirements in benefit schemes, the disincentives embedded in present arrangements will undoubtedly contribute to marginalisation and benefit-dependence among low-wage workers. This is demonstrated by the fact that more than 40 per cent of those most affected by

unemployment (being unemployed more than 80 per cent of the time) face effective replacement rates above 90 per cent, while of those with only a few and short unemployment spells, under 20 per cent face such rates.(28)

Strong disincentives are also evident in schemes pertaining to older workers, where the take-up rate of early retirement (efterlonnen) for 60 to 66 year olds (at unemployment benefit level for the first three years but thereafter capped at 82 per cent of maximum unemployment benefit) is around 80 per cent among unskilled workers, and around 35 per cent among those with a higher education. It has been calculated that the full set of transfers available to older Danish workers has implied an internationally high effective tax rate on continuing to work, insofar as the transfers available upon withdrawal at the age of 55 constituted 50 per cent of income from full-time work up to the age of 64.(29) Take-up rates were high among low-skilled workers after the inception of the scheme in 1979, but the continued expansion of early retirees - more than 80 per cent since the mid-1980s - reflects a more widespread use among other groups.(30) A further impetus was given by the early withdrawal scheme (overgangsydelsen) for long-term unemployed 50 to 59 years old during 1993-96, which resulted in many of the low-skilled leaving the labour force. This was seen as a one-off effect which would be directed at a highly marginalised group of workers and thus expected to lower long-term unemployment by a corresponding amount. But it appears in retrospect that both the flow into and the outflow from long-term unemployment is higher than expected: the early withdrawal scheme actually catches long-term unemployed who would otherwise have moved back into jobs. Indeed, the fall in the number of 50 to 59 year old long-term unemployed since 1994-95 has not been different from that of lower age groups.

A third transfer scheme - early retirement pension (fortidspension) is available to persons of all ages who for health and social reasons are unable to participate in the labour market (thus filling the functions of disability pension in other countries). The annual gross inflow into this scheme is presently around 20 000 to 25 000, and the stock of pensioners has increased by 16 per cent since the mid-1980s, from 233 000 to 270 000. The increase has been most pronounced for the age group below 50 years. The scheme is administered by municipalities and is recognised as having been used far too often to take care of labour market-related problems at local level, even though recipients would often appear to be able to carry on working. Close to a half indicate that they would be capable of working, about one third of these in standard jobs. In the public debate, proposals have emerged to the effect that the early retirement (disability) pension be only available to persons without work capacity, while persons with a partial capacity will be given a wage subsidy corresponding to the incapacity and a requirement to accept jobs offered.

The stricter formulation and enforcement of job availability requirements attaching to unemployment benefits has also been extended to social assistance benefits. All recipients are obliged to take part in compulsory activation - originally after thirteen weeks for youths below 25 years of age with unemployment as their only problem, and after one year for all above 25. From July 1998 compulsory activation has been extended to all recipients and the thirteen-week limit now applies to everyone up to 30 years of age. Activation is administered by municipalities and has to be underpinned by an individual action plan for all above 25 years of age. Being non-insured, recipients of social assistance have hitherto not been obliged to register with Employment Offices, but municipalities are now required to ensure that recipients with unemployment as the only qualifying reason are registered and available for job placement.

Greater reliance on market signals in labour market policies

As noted in the in-depth analysis of the education system in the 1997 Economic Survey, the government is the chief provider of training both to employed and unemployed. In the Danish case, the government finances about 70 per cent of overall expenses for adult education and training, the remainder stemming from costs

incurred by enterprises and participants themselves.(31) The comparable figure for Sweden has been estimated at 30 per cent, close to that pertaining to Germany and the United Kingdom, reflecting enterprises' own responsibility for providing training for their employees in these countries. Since Danish enterprises do not bear any of the costs of demanding further publicly-provided education for their employees, this was seen as potentially leading to excess investment in the adult education and training system. The division of costs underlying the system has been retained. Moreover, user fees for participants, which had been introduced in 1995 to be gradually increased up to 2000, were abolished in late 1997. The combination of a free choice for enterprises and a "taximeter" system of finance, whereby current costs of training programmes are automatically covered, has allowed enterprises to choose the most relevant training programmes from their perspective; but they have not been assessed against the cost to society of providing them. The recent curtailing of the use of taximeter grants in both formal and adult education should be seen against this background.

Strengthening skill and competence acquisition

The concerns and recommendations listed in the in-depth analyses of the education sector in the 1997 Economic Survey appear, in most respects, to match those of the Danish authorities, particularly with respect to the lower-than-expected return on resources allocated to the formal education system. A joint report from the central decision-making ministries published in early 1998(32) identified low skill acquisition as an important problem, linked to inadequate motivation and incentives to complete an education at upper secondary level and to pursue higher studies. Institutional failure also plays its part: teaching deficiencies have been identified in core subjects, together with a lack of systematic evaluation and a failure to lay down clear objectives. A range of recommendations have been put forward for dealing with these deficiencies and a series of initiatives are in train, aimed at using the large amount of resources devoted to education more efficiently and achieving both enhanced educational attainment levels and a better matching of curricula formulation with needs in the economy (see Box 5 for details).

Increasing product market competition

Denmark has long benefited from the division of labour through international trade. The internal-market programme of the European Union added strength to this process by ensuring a more level playing field across countries and sectors and thereby exposing domestic industries to stronger competition. Denmark was the first country to implement in full all the EU directives on the internal market (accomplished in 1997). Selective industrial support has been more or less completely abandoned in recent years, support from central government for such purposes (low at the outset) having fallen by 95 per cent over the 1993-98 period. On the other hand, other components of business sector support, such as central government expenditures for research and development, for environmental purposes and for developing the private services sector, although on the whole low, have been expanding (Table 13). According to the most recent figures, Denmark has lost its position as one of the least intervention-prone countries in the European Union with respect to state aid to manufacturing - only the United Kingdom was lower in the late 1980s - to being an average-country in this respect [ILLUSTRATION FOR FIGURE 16 OMITTED]. Also, direct support to business is far smaller than revenue foregone through preferential tax treatment of the sector. Nevertheless, in view of the reorganisation of support to shipbuilding in recent years, with costs being brought forward to reflect commitments incurred rather than the time of pay-out of financing subsidies, it is probably correct to say that present figures overestimate costs while earlier ones may have underestimated them. Moreover, with implicit support through government interventions being replaced by explicit support and tax expenditures continuously being monitored, the Danish business support regime has gained in transparency in recent years.

The competitive framework has been strengthened with the new Competition Law which entered into force on 1 January 1998 and which has replaced the abuse principle hitherto in force with the prohibition principle used in most EU [TABULAR DATA FOR TABLE 13 OMITTED] countries. Whereas practices restraining competition were previously allowed unless explicitly forbidden, the new framework prohibits such practices unless explicitly allowed. The act embeds a prohibition of agreements to restrict competition as well as abuse of dominant position (except in cases of minor significance - bagatelgroenser). The "group exemption" clause applied by the EU has also been incorporated and in some cases adapted and extended to reflect Danish circumstances, implying that co-operation in retail trade chains - covering as many as 130 agreements with some forms of horizontal co-operation - is still allowed. !n common with some other small EU countries and reflecting the dominance of small and medium-sized enterprises in the domestic economy, Denmark has not opted for obligatory merger control. Recognising that mergers may act to restrain competition, the act nevertheless lays down a reporting requirement for all mergers entering into force.

With the new act, the private enterprise sector operates within the same framework as its foreign competitors. Moreover, public business activities have been brought fully within the purview of the new act. However, competition considerations are not allowed to override other public objectives laid down by law or by regulations/directives mandated in law. The borderline will be less clear in some areas than others, and while regulations given by central government most often will deal with specific and precisely defined areas, municipalities have a general authorisation to enforce such regulations as they deem necessary to fulfil the tasks allocated to them by law. The exemption from the general competitive framework only applies to internal deliveries from municipally-owned producers, but scope may exist for continued preferential treatment of such enterprises. The outcome in this area will be determined by the verdicts issued by courts on individual complaints brought before them.

For the private sector, the Competition Act - although central - is only one of several parts of the overall framework deciding competitive and structural developments. A case in point is retail trade where a new act on opening hours was implemented in 1995, implying a substantial liberalisation. Opening hours from Monday morning (06.00) to Saturday evening (17.00) are fully at the discretion of shops themselves, while opening on Sunday is reserved for grocery shops and other retailers of non-durable goods with a small turnover. A preliminary evaluation indicates positive effects of this modification, with the closure rate among retailers of non-durables falling markedly in 1996 (a trend also attributable to the strong upturn in private consumption). Formulated with the same considerations in mind - but more controversial - has been the adjustment in the planning act regulating land use in urban and rural areas, which obliges larger municipalities to allocate land for new retail trade entities in the centre of towns and to ensure that their size are kept fairly small. (The limits are below 3 000 square metres for retailers of non-durables - dagligvarer, and 1 000 square metres for specialised stores - udvalgsvarer.) At the same time, development of large commercial centres (shopping malls) outside town centres are being curtailed until comprehensive regional development plans have been presented, at times with evidently adverse effects on the location decisions of businesses. While Danish retail trade has a diversity lacking in neighbouring countries and well worth preserving, the quantitative regulations embarked upon may only serve to put the sector at a disadvantage when across-border competition intensifies, inter alia with the new bridge to cross the Sound to Sweden.

A third element affecting the competitive environment is the array of government and branch-imposed regulations which determine the barriers to entry in a given trade or profession and set standards for the conduct of established enterprises. Motivated by considerations pertaining to the security and quality of supplies, the environment, income redistribution and social and health developments, such regulations have, in general,

reduced competitive pressures in the sectors concerned, thereby leading to higher prices and adversely affecting resource allocation and product innovation. Following the comprehensive revision of the competitive framework in 1990, the competition authorities have worked systematically to uncover the extent and effects of such regulations. The self-regulating (and self-imposed) activities of branch associations have been sharply curtailed (Table 14), whereas the efforts vis-a-vis other public bodies are taking a longer time to come to fruition. Of particular importance are the regulations imposing barriers to entry by mandating monopolies or establishment by public concessions. Such regulations are concentrated in energy supplies, transport and communications - the traditional utility sectors.

Utility sectors in most countries have seen a shift in regulations and ownership modes over the past decade, resulting in a separation of the network functions (characterised by elements of natural monopoly) from service activities, the latter being converted into incorporated enterprises. Danish efforts have been concentrated on the telecommunications sector, with the government-owned Tele Danmark being partially privatised in 1994 (the government lowering its stake to 51 per cent) and the remainder being sold to the US company Ameritech in 1998. Tele Danmark has not been forced to part with any of its activities, but it has been exposed to increased competition, particularly in mobile telephony. The fact that the number of suppliers is limited has necessitated price regulations to avoid above-normal profits in the initial years, but with new band widths opening up, new competitors are entering the market. Of equal importance are the conditions offered to competitors for accessing the fixed-line network owned by Tele Danmark which was opened in 1996. With effect from 1 July 1998, Parliament decided to give competitors access to the network through a service-provider agreement which determines the access price as competitors' final prices minus 21 per cent. Alternatively, competitors may use the net ("the copper wires") to set up their own exchanges for a cost-based price but including a mark-up of 12 per cent. While imposing some restrictions on the incumbent, these arrangements ensure a steady flow of revenues to Tele Danmark and limit price competition compared with a fixed access price to the network.

Table 14. Barriers to entry and regulation of trade

	1990	1997
Barriers to entry		
Public regulations		
Monopoly/concessions	44	32
Limits on market participants	7	10
Regulation of trade		
Public regulations		
Price regulations	9	10
Restriction on advertising	3	15
Co-operative regulations	4	4
Branch regulations		
Price regulations	43	4
Restriction on advertising	8	0
Co-operative regulations	8	0

Total 126 75

Source: The Competition Board.

A separation of the network from current operations has been undertaken for railroad transport and entry opened up in freight transport, but with no effect on market structure so far. On the passenger side, a market separation exists, private lines co-existing with the main government-owned provider (DSB). But such lines have remained on their own networks and have not sought to expand their activities. Overall, railroad transport is not competitive in Denmark and is only being sustained by higher subsidies than other modes of transport.(33) Regulations also prevent inter-modal competition in long-distance bus transport, bus transport across county borders is subject to concession, with the key criterion being if the route is already served by public transport. Since the majority of applications during the last two decades have been rejected, Denmark has become the only western European country with only limited networks of long-distance bus transport. Even the opportunities provided by the new Zealand-Funen bridge for time- and cost-efficient day-time bus transport across the country are not being exploited insofar as applications are again being rejected.

In-house production provided by central and local government as a part of their legal obligations to the general public are, in principle, exempted from the Competition Act so that the rules guiding public tenders and outsourcing are critical in determining the overall competitive framework. For services provided by the central government, strict guidelines issued by the Ministry of Finance require public tenders at regular intervals to ensure that costs are minimised. The constitutional independence of local authorities gives them the choice between relying exclusively on in-house production or tendering, and only in the latter case do public procurement rules apply. The Danish evidence points to substantial gains from tenders leading to an outsourcing, a survey covering 20 municipalities and counties showing an average cost reduction of 14 per cent. Public transport is a case in point, with the municipality of Copenhagen realising cost reductions of 24 per cent from using public tenders since 1990. Costs are 55 and 30 per cent below those of two other metropolitan areas (Arhus and Odense) using in-house production. Outsourcing in this context will often imply giving a single company a time-limited monopoly on all public transport services in the area. The corollary that such companies may lose the contract in the next tender tends to eliminate companies without some financial strength and a wide range of operations. Nevertheless, the concentration on the supplier side is more than offset by the contestability induced by the public tender and outsourcing process.

While deregulation has been proceeding at a fairly rapid pace in most utilities sectors [ILLUSTRATION FOR FIGURE 17 OMITTED], the main exceptions are the energy sectors, where regulations are rooted in the experience of the 1970s and embody a high degree of quantitative planning and price-setting subject to central government approval. The mutual organisation of the electricity sector means enterprises are run on a non-profit principle and since the power generation companies are often owned by distribution companies, prices have been set on cost-plus basis. Incentives to innovate have been weak, all the more so since production has been guaranteed an outlet to customers being obliged to purchase from their local supplier. A decision by the Competition Council, which demanded that one of the two dominant distributors(34) open its transmission grid to a competitor, has led to a modification of the Electricity Supply Act with effect from 1 January 1998, implying some strengthening of competitive pressures. But the Act affirms the security of supply, environmental and consumer-protection considerations. The opening of the market so far applies only to the seven largest final consumers (with a market share of 3 per cent) and 55 distribution companies (with a market share of 90 per cent), which are allowed to shop around for energy supplies. As power-generation and distribution companies are highly vertically-integrated, the effect on competition is likely to be negligible, and it remains to be seen if the transmission grid will be accessible on a non-discriminatory basis. While the threshold for allowing final

consumers to enter this segment (an annual consumption of 100 GWh) may be changed by administrative fiat, it has also been stated that this will only be done to comply with new EU directives. Counting in the formal opening of the market for distribution companies, present regulations allow Denmark to exceed the initial requirement of 22 per cent liberalisation of the total electricity market contained in the 1996 EU directive which will enter into force in February 1999.

In the light of experience from both the United Kingdom and the other Nordic countries, proposals for a far-reaching deregulation and re-organisation of the energy sector have become a recurrent feature of the domestic structural policy debate, the most recent contribution coming from the Competition Board.(35) An opening of the electricity market requires a separation of power-generation (exposed activities) and distribution (natural monopoly) with equal access to the transmission and distributions networks for all final consumers. The ensuing competition will favour the most efficient producers, allowing electricity to be produced at a lower cost than today. As surplus capacity is absorbed, cost levels should fall by around 10 per cent.(36) A further boost to competition would follow from a complete market integration with other Nordic countries, possibly also extended to Germany. At present, Danish electricity prices are higher than in Norway and Sweden but lower than in Germany. A Nordic integration will primarily benefit Danish consumers by lowering their prices. An integration also with the German market will not benefit consumers directly. However, higher profits will translate into higher tax revenues from energy producers - hitherto exempted from paying taxes - which will benefit consumers as tax payers.

In an increasingly competitive environment, the present organisation of the energy sector is hardly tenable. Stronger competition means higher bankruptcy risk for individual enterprises which will expose consumers directly as owners of these mutual companies. A reorganisation to (limited-liability) joint-stock companies would seem the most efficient way of organising the exposed part of the electricity sector. Such a reorganisation will bring into the open the underlying value of electricity companies which are far above their current book value. A reorganisation of the Danish energy sector thus involves a redistributive aspect - how to share the values created by electricity consumers in a geographically restricted area over a long period of time. In the absence of a fully thought-out model, attempts to realise such values by selling off parts of municipally-owned companies have so far been counteracted by government regulations which reduce block grants to such municipalities. Several models are now under discussion. One is to return values to consumers through low electricity prices, with the implication that Danish industry and households will be facing prices below the relevant social opportunity cost which is that given by prices in international markets. The remaining options would be to let the values accrue to the public sector, either to municipalities with clauses upon their use to avoid destabilising effects to the economy, or directly to central government as a way of lowering public debt and future tax levels. Moreover, formulating a regulatory regime for the monopoly parts of the system appropriate to Danish circumstances has to take into consideration the fact that electricity is produced jointly with heating for urban districts in dual-purpose plants, implying the risk of cross-subsidisation between the two activities of energy-generating companies.(37) A further consideration is how to integrate environmental considerations in an efficient way (see Box 6).

Assessment and scope for further action

The structural reform process in Denmark is broadly based, involving the labour market, product market, and education policies. The process is tightly organised, with the relevant ministries and their subordinate bodies reporting regularly on progress made and issues outstanding. Progress is most pronounced in labour market policies proper, and the first two stages of reform have been implemented. They have just recently been

evaluated with a view to developing new initiatives to ensure that the overall goal of a reduction of structural unemployment to 5 per cent by 2005 can be achieved.

In the view of the Danish authorities, five specific features stand out with respect to experience gained in the field of labour market policies:(38)

* Interaction between the ordinary placement services of labour-market offices and the compulsory activation of the unemployed has become of key importance during the strong expansion of labour demand and the ensuing danger of bottlenecks. The key elements in this respect have been the devolution of labour-market policies to regional bodies, the placing of a wider set of instruments at their disposal, and the stricter enforcement of job availability rules. The content and formulation of compulsory activation at regional level needs, however, to be developed further to ensure that activation is not an alternative to idle unemployment but a preparation for integration into the ordinary labour market.

* Compulsory activation after two years of unemployment is a part of the reform programme and has been gradually phased in up to end-1998. Compulsory activation redirects the resources of labour offices and may be seen as reducing flexibility in instrument use compared with the fully discretionary use of ALMPs prior to 1995. However, one of the sought-after effects of the duty to be activated is to alter the search behaviour of unemployed, towards a more realistic assessment of their labour-market prospects and the need for further education. These motivation effects are seen as gradually emerging.

* Training and education are a central feature of compulsory activation, but activities so far reflect more the historical design of the system and not what the unemployed need. This effect is reinforced by wrong price signals since places in adult education under the auspices of the formal education authorities are financed outside the budgets of labour market authorities. Further efforts are needed to adapt the choice of training to enterprises' demands.

* Job availability requirements have been made tighter in recent years. However, the application of these requirements by the union-administered unemployment insurance funds is still found too lenient and needs to be tightened.

* Paid-leave schemes for child-minding and sabbatical leave have been tightened and the latter is about to be closed off, while the access of unemployed to paid leave for education has been tightened. The number of persons on paid leave has thus fallen. However, in view of the strength of labour demand and the claims made by other transfer schemes, further efforts are required to strengthen labour supply.

Based on the above experience, the Danish authorities tabled a set of proposals, which have been implemented as part of the 1999 economic policy programme.(39) Labour-market policies will continue in their present form, and their scope extended by bringing forward compulsory activation to take effect after one year of unemployment instead of after two years with a reduction of the total benefit and activation period from five to four years. The strict UI benefit regime for youths without a qualifying education will be extended to all youths below 25 years of age. This will be achieved by subjecting those with a complete vocational education to compulsory ALMP participation at 82 per cent of UI benefits (dimittendsatsen) after six months of unemployment (as opposed to 50 per cent for those without a qualifying education). At the same time, higher priority will be given to older unemployed on ALMPs, a move reinforced by removing the exemption of 50 to 54 year olds from the upper time limit on UI benefits, which has exempted them from compulsory activation when entering their third year of unemployment. More generally, the long-term unemployed and other with weak labour-market prospects will face stricter enforcement of job availability requirements. This will be combined with the fuller utilisation of the present job availability requirements with respect to geographical and

occupational mobility, combined with stricter control of UI-funds. Proposals have also been put forward for dealing with the overlap between educational measures integrated in individual action plans (which are formulated by employment offices and constitute part of the compulsory activation) and the access of the unemployed to paid leave for education. The latter entitlement, with very weak employment effects, has been reduced to six weeks from the one year so far available. In consequence, financing and implementation of education and training of unemployed should from now on rest entirely with Employment Offices. A reform of Unemployment Insurance has also been put on the agenda, with a revised system likely to be put in place by 2001.

On the evidence available and experience gained in recent years, the proposals of the Danish authorities, while pushing the reform process forward, could be made more general in a number of areas (see Box 7). The marginalisation of weaker labour market groups has been an inherent problem in the Danish labour market and each previous peak of unemployment has been followed by an extension of one of the several schemes to take those being marginalised out of the work force, thereby modifying the behaviour of workers, unions and enterprises and entrenching benefit-dependence on an even wider scale.(40) The fall in the effective retirement age can be attributed to a declining age of those leaving the labour force via unemployment and not of those leaving directly from employment. To counter this trend, economic incentives have to be modified, motivating workers to remain in the labour force on one hand, and, on the other, slowing inflow into unemployment.(41) A reformulation of transfer schemes affecting retirement decisions and reservation wages generally through their high replacement rates appears to be the main challenge to Danish labour market policies. Such policies would address the problem at root without adversely affecting incentives for other workers which is clearly the case for the often offered proposal of introducing earned-income tax credits. Although this is suggested as a way of improving incentives for low-paid workers, closer analysis indicates that in the Danish case - characterised by a strong compression of wages and generous unemployment benefits - such schemes do not add much to labour-market performance.(42) Costs to enterprises of hiring such workers will remain basically unchanged, and recouping the lost revenue from the tax credit elsewhere in the tax system would exacerbate already higher marginal taxes for other groups and adversely affect incentives to undertake higher education.

In product markets, the legislative framework has been given a more competitive edge with the new Competition Act. The Danish approach does not allow the considerations and requirements laid down in this act to override sector-specific legislation, so further efforts will have to concentrate on reviewing and sharpening the competitive impact of the latter. The duty of the Competition Board to assess the impact of public regulations and follow up vis-avis authorities responsible should be helpful in this respect, not least vis-a-vis practices in the municipal sector where the legal framework leaves significant scope for favouring in-house production. Steps have been taken to modify several sector regulations with a view to their competitive impact, the most recent being the telecommunications act. The incumbent in this sector, although dominant, has seen its powers proscribed in recent years, a strategy not used in the transport sector where support of rail at the cost of road transport restricts consumer choice and impedes competition. The energy sector has in many ways defied the overall trend towards deregulation and is deeply entrenched in heavy regulations, sheltering producers from both external and internal competition. A recent opening of the market can only be seen as a minimum solution to comply with requirements given by EU directives, still leaving Denmark out of step with neighbouring countries. A fully competitive framework holds out the promise of significant efficiency gains.

In sum, the implementation of wide-ranging structural reforms has improved economic performance in particular with respect to moderating wage and price growth during a strong economic upturn and allowing a rapid reduction in unemployment. The momentum of the reform process is being maintained in the overall

formulation of economic policies, but would further benefit from more decisive action to address the disincentives to labour supply in the tax and transfer system, improving the returns on the resources committed to the education system and strengthening the competitive framework for the business sector in general and public utilities in particular. Of special importance are steps to remove disincentives to continued labour-market participation for older workers and to eliminate the higher unemployment risk facing low-skilled workers. Reform of related transfer and benefit schemes is crucial to the mobilisation of labour for further economic growth, not only directly in terms of labour supply, but also through a wage formation more conducive to structural change and human capital development. An overview of policies undertaken and recommendations for further measures are summarised in Box 8.

[TABULAR DATA FOR BOX 8 OMITTED]

IV. Policies for the housing market

Introduction

The provision of housing of satisfactory quality at a reasonable cost to households has been a central feature of the development of the European welfare states in the post-war period. Relieving the physical housing shortage was an overriding priority in the immediate post-war decades, to be replaced subsequently by policies to overcome the urban and social problems which were, in part, associated with the high-rise, low-cost buildings which were the expedients for solving this shortage. In consequence, the objectives and functions attached to the housing sector became broader and more varied in scope, often embracing explicit distributional motives, requiring a continuation of extensive government intervention and a substantial budgetary commitment. While countries such as the Netherlands, Sweden and the United Kingdom have seen public authorities seeking to retreat from their dominating role in the housing sector in recent years, Danish housing policy has been characterised by a greater degree of continuity, the policy framework developed up to about 1980 still being largely in place. Questions may nevertheless be raised as to the sustainability of this framework, insofar as the long-term costs of resource misallocation caused by direct price regulations are becoming all the more evident, the strain on public finances from a variety of direct transfers is not receding, and the housing market remains a crucial element determining the cyclical pattern of the Danish economy. At the same time the distributional effects of housing policies are seen as increasingly unfocused, incurring costs in terms of disincentives to labour mobility. All this calls into question the advisability of maintaining targeted support to housing in a situation of overall high housing standards, of providing support to bricks and mortar rather than to individuals in need, and of using direct price regulations to try to accomplish distributional objectives.

This chapter begins by setting out the main objectives and achievements of Danish housing policy, describing the main institutional features of the housing sector, especially with respect to ownership and the incidence of rental housing. This is followed by an overview of the system of housing finance and the main instruments of government intervention. The second part is devoted to an assessment [TABULAR DATA FOR TABLE 15 OMITTED] of the economic impact of this system, in terms of the resources committed, their budgetary impact, the cyclical behaviour of the housing market and its interactions with macroeconomic variables, the incentives to an efficient utilisation of the housing stock, and distributional and labour-market outcomes. The final part gives an overall assessment of the system and policies pursued together with recommendations for policy change.

Objectives, institutions and instruments

Underlying Danish housing policies up to the present has been the objective of securing an affordable, satisfactory and healthy dwelling for all. In broad terms, there can be no doubt that this has been achieved. The

number of dwellings doubled over the 1945-1995 period - thereby outstripping population growth by a substantial margin - reflecting both a high level of construction of new dwellings in the 1960-1970s period and a more recent effort to renovate and modernise older buildings. In consequence, housing coverage measured as the number of dwellings relative to the number of households is among the highest in Europe while the average size of dwellings is the highest in the OECD. And despite the fairly high proportion of older dwellings still in use, the housing stock would still appear to be of relatively high quality (Table 15).

Stability among tenures in recent years

In terms of tenure, the Danish housing market encompasses four different segments, each characterised by a different set of legal regulations and economic instruments:

* The owner-occupied segment, comprising single-family (the dominant component) and multi-family houses and condominiums, has traditionally been seen as the top end of households' careers in the housing market. Reflecting high activity in this segment in the 1960s and 1970s [ILLUSTRATION FOR FIGURE 18 OMITTED], the proportion of the housing stock belonging to this category increased gradually to about 55 per cent in 1980 where it has since remained. In economic terms, owner-occupied housing serves not only as a provider of services to the household, for the majority of such households the housing stock serves also as the major mode of wealth accumulation.

* Private rented housing has historically been the main alternative to owner-occupied housing but reflecting government interventions which either disfavoured investment in this segment or gave financial advantages to other segments - all documented in more detail below - the proportion of the housing stock belonging to this segment has fallen from above 30 per cent in the mid 1960s to just below 20 per cent in 1997.

* Rented housing provided by housing associations, known as social housing, is basically a post-war undertaking and has increased its share of the housing stock from just above 10 per cent in the mid 1960s to 20 per cent in 1997.

* Co-operative housing was institutionalised in the 1970s in order to allow tenants in private rented housing to buy their property and such property, together with a certain number of recently constructed co-operatives, today represents 6 per cent of the number of dwellings.

The pattern of Danish housing would appear to conform rather closely to the European average, with the prime examples of above-average reliance on one particular segment being southern European countries, Finland and Ireland [TABULAR DATA FOR TABLE 16 OMITTED] (owner-occupied housing), Switzerland and Germany (private rental housing), the Netherlands (social rental housing) and Sweden and Norway (co-operative housing) (Table 16).

Individual property rights concentrated on owner-occupied housing

The Danish legal framework does not significantly restrict the economic disposition of owner-occupied housing; consequently, the dwelling can be freely traded and put up as collateral, and capital gains - or losses - upon the sale of the asset will accrue fully to owners. Members of housing co-operatives are in quite a different situation insofar as they are owners not of a flat but of a part/share in the co-operative, embodying a right to use a specific apartment, but with all decisions concerning maintenance and improvements resting with the cooperative. The shares can be sold but their price is subject to maximum price regulations, restricting potential capital gains; on the other hand, the member of a co-operative has a limited liability in case of bankruptcy of the co-operative insofar as the share will be used to cover outstanding debt, but she/he is entitled to stay on as a tenant. While public regulations allow shares in co-operatives to be put up as collateral, most co-operatives have

their own regulations which prohibit such a use. Social housing does not confer property rights upon the individual tenants even though they wield an extensive influence on the apartment in which they live and on the general economic dispositions of their housing association through representation on the managing board; however, their capital deposit when becoming members of the association is only notional and is not adjusted over time to reflect general price trends. Of stronger economic significance is the legal requirement that these associations should be run as non-profit societies with rents basically being determined from their costs, of which interest payments and amortisation of the initial capital outlay are the major components. This regulation acts as a de facto rent control in social housing, implying from an economic perspective a simultaneous maximum and minimum price regime.

A long-standing tradition of rent control

The most extensive government interference with the economic discretion of owners takes place in private rented housing, where rents have been subjected to controls throughout the post-war period; it was only in 1991 that it was decided to exempt rented property built after that year from such controls. In economic terms, rent control implies a transfer of resources from landlords to tenants and may in the short term be seen as an alternative to redistribution through taxation of rental income and subsidisation of rent payers out of the proceeds. Insofar as owners of this stock receive a return on their initial investment below that of alternative capital uses, the long-term effect is a run-down of the housing stock or efforts to convert it to other uses or other segments in the housing market, often necessitating further regulations to close off windows for conversion and capital gains for owners. Converting rented housing to cooperative housing and to condominiums became legal options in the 1970s, although the latter option was later closed off, while demolishing property in use as rented housing has in general been prohibited. Tenants are also protected by the stipulation of open-ended leases as the standard contract, only to be interrupted at the landlords' discretion in a few precisely described cases. At the same time, the right to sub-let rests with tenants who also have a right to barter tenancies.(43) In broad terms, tenants have been allowed to capture an increased economic value of their tenancy arising from generally rising property values.

Rent control has been a permanent feature of the Danish housing market for about 60 years, the present system of rent controls having its origin in a reorientation of housing policy in the mid-1960s, intended to bring rents in private and social rented housing up to market-clearing levels over the period 1967-74. The plan did not foresee the strong increase in inflation in the early 1970s and was not adjusted to take this into account, The ensuing rent level in 1974 - in real terms more or less the same as in 1967 - was therefore still far from market-clearing levels and efforts to prolong the adjustment period were not pursued. In addition to the revised basic rent control act (Lejeloven) which was formulated on the basis of market-clearing rents, a supplementary act (Boligreguleringsloven) relying on cost-based rents was therefore introduced in 1975 and municipalities were allowed to choose between the two rent regimes. The new system nevertheless implied an increase in rents of about 40 per cent in nominal terms somewhat below 30 per cent in real terms - in the year immediately after its inception. At present, 85 per cent of the private rented stock is to be found in municipalities applying cost-based, regulated rents. Landlords in these municipalities are allowed to pass on all costs, property taxes included, actually incurred in the day-to-day operation of the property and a prescribed charge to cover maintenance costs. The capital charge was restricted to 7 per cent of the unadjusted nominal value of the property following from the 1973 tax assessment but was raised by 10 to 15 per cent in 1994. For property dating from 1974-1991 the capital charge was adapted to the conditions of their financing and appears to have allowed rents to be determined on the basis of demand and supply, in line with that applying to property dating from 1992 and later. Insofar as other elements have been included in the cost basis for rents (inter alia, an

increase close to 50 per cent in prescribed charges for future maintenance), rents in the private rented segment have increased substantially in real terms over the past two decades (by 4 1/2 per cent per year) and also relative to rents in social housing [ILLUSTRATION FOR FIGURE 19 OMITTED].

Preferential tax treatment of housing

The tax regime applying to the different segments should be seen as a counterpart to their legal status and the price regulations imposed on them. Housing associations supplying social housing and housing co-operatives are nonprofit institutions, and income taxes are not levied on these societies (with interest costs thus having to be incurred in full). While owners/landlords of private rented housing - whether individuals or enterprises - in general are subject to ordinary income taxation, a special regime applies to pension funds and life-insurance companies: a real interest tax (realrenteafgiften) is levied on the return of their portfolio above a 3 1/2 per cent real rate. Those assets which are held as property for rented housing were, however, exempted from this tax until 1986 (and again in 1993-94) and pension funds and life-insurance companies have been the main investors in rented housing over the past fifteen years. A similar tax exemption is applied to the return of index bonds held by these institutions. With the 1998-2002 tax reform recently adopted (see chapter II above), the real interest tax will be converted to a proportional tax with a rate of 26 per cent while the exemption for investment in indexed bonds will be removed.

At the personal level, residential property is taxed by the imposition of a tax on imputed rent, based on a 2 per cent rate of return of the tax-assessed value of the house (in principle in line with market prices) for values below a certain limit and on 6 per cent for values above that. While the Danish tax system embodies a parallel treatment of the two different components of capital income - interest, rents and dividends on one hand and (realised) capital gains on the other - this principle is in practice not applied to residential property, with capital gains and losses upon the sale of a house being tax-exempt. But in accordance with this model of capital income taxation, all capital expenses/interest payments are deducted from capital income to arrive at the taxable income concept. Insofar as the 2 per cent rate applied to the imputed rent is far below the return on financial investments and borrowing, in real terms around 5 per cent, housing investment receives an implicit subsidy through the tax system amounting to 1 1/2 to 2 per cent of GDP.(44) Other departures from a fully neutral tax system, most importantly a 1 per cent imputed rent for houses owned by pensioners, add an amount equivalent to 1/4 per cent of GDP to overall tax expenditures for housing. However, with the marginal tax rate applying to interest payments falling from typically 55 to 60 per cent in the early 1980s to 40 to 46 per cent in 1998, the implicit subsidy to owner-occupied housing has been reduced markedly over the past fifteen years. This process is set to continue with the 1998-2002 tax reform which gradually lowers the marginal tax rate to 32 per cent: at the same time, the taxation of the imputed rent will be replaced by a property tax, which also serves to raise the costs of investment in owner-occupied housing insofar as the hitherto applied standard allowance will not be available to property which changes ownership. Finally, the government has also chosen to levy a stamp duty on transactions of houses, which together with value added tax on services rendered adds about 3 to 4 per cent to sales prices.(45)

... an elaborate financing system

Long-term housing finance is basically provided through mortgage institutes, which fund themselves in the extensive Danish bond market. Total outstanding bond issues amount to twice the GDP-level and half of this consists of mortgage bonds. Mortgage institutes are prohibited from taking on interest rate exposure, forcing them to match the maturity of lending and borrowing. Combined with their fully collateralised and fairly homogenous loan portfolio, institutes have been able to keep margins at very low levels.(46) Bond issuance is

also regulated with respect to maturity and the loan-to-value ratio, and the authorities may also influence the effective repayment schedule (duration) on new mortgages by regulating the mix between nominal and indexed bonds and between annuities and serial bonds. These regulations have been used to impose somewhat different financing regimes upon the segments of the housing market:

* Owner-occupied housing is generally financed through nominal bonds with a maturity of 30 years and with maximum loan-to-value ratios of 80 per cent, additional finance to be obtained either through bank loans or own savings. At present, this regulation applies to construction of new homes; acquisition in the second-hand market; maintenance and improvement work and borrowing against own equity. Equal treatment of the different purposes is of relatively recent date, historically they have all faced different regulations. Mortgages are now typically annuities and issued with an option for the borrower to redeem the bond at par (equivalent to "capped yield" bonds). The latter feature is reflected in the price setting of bonds giving rise to a yield premium of 0.1 to 1.0 percentage point depending on the coupon rate and it has contributed to recurrent conversions of bonds in times of falling yields.

* Social housing has to be financed through index bonds, with a loan-to-value ratio of 84 per cent, with additional finance being supplied by municipalities (14 per cent) and tenants' deposits (2 per cent). The reference maturity of the index bond is 35 years for zero inflation, at present inflation rates the maturity is about 42 years. The repayment of the municipal loan is subject to the financial situation of the association and not obligatory until after a 50 year grace period.

* Co-operative housing is typically financed through i) nominal bonds with a maturity of maximum 30 years and a loan-to-value ratio of 80 per cent, in the case of conversion of a private rented property; or ii) through index bonds with a maturity of 35 years or more, with a loan-to-value ratio of 80 per cent, for construction of new co-operatives. Insofar as tenants do not own their own apartment and cannot furnish collateral, second-hand purchases have to be financed through banks rather than mortgage institutes.

... and a wide range of subsidies

The differentiation of financing regimes mirrors different levels of government "object support" - often referred to as "brick and mortar" support. While owner-occupied housing receives only indirect support through the tax system, social housing as well as recently constructed co-operatives benefit primarily from direct government support which lowers the expenditure related to interest payments and amortisation of the indexed loans. The total rent paid by tenants in social housing is initially (after one semester of grace) restricted to slightly above 2.1 per cent of the outstanding debt and is thereafter raised only by three-quarters of the inflation rate (as measured by the increase in the net price index or manufacturing hourly wages, whichever happens to be lower). The remainder of the expenses necessary to cover payments to bondholders - both the 2 1/2 per cent coupon and the full indexing of the loan - is then covered by government subsidies. For co-operative housing, subsidies are somewhat less generous with the initial repayment rate set at 2.5 per cent; moreover, social housing benefits from the extremely long grace period of municipal loans. If particular advantageous schemes for dwellings for youths, pensioners etc. are taken into account, this component of object support amounts to around 1/2 per cent of GDP.(47)

The attempted reorientation of housing policies in the late 1960s brought in housing benefits for low-income families to compensate for the rise in rents in the two rental segments. This transfer (boligsikringen) is thus restricted to tenants. However, housing benefits for pensioners (boligydelsen), which were established in 1979 and are extended to both old-age and disability pensioners, are paid regardless of tenure, although the overriding majority (96 per cent) of its recipients are tenants. Housing benefits depend on the size of the

household and its income, the rent paid and the size of the dwelling.(48) Subject to an upper ceiling for the rent compensated and for the housing benefit itself, housing benefits for non-pensioners cover three-quarters of the difference between the rent and an income-dependent minimum payment, while the more generous rules for pensioners entail 90 per cent coverage of housing costs above an income-dependent minimum payment. In its present format, housing support is extended to 22 per cent of all households, with as many as 58 per cent of tenants in social housing and 32 per cent in private rented housing being recipients. It covers a quarter of all rents paid in the rented segments at a cost to the public purse of more than 3/4 per cent of GDP.

An incomplete policy transformation

In terms of policy regimes, Danish housing policy can be seen as being in a transition from an object- to a subject-orientation, with housing benefits gaining ground at the expense of brick and mortar subsidies. This transformation is far from complete. in terms of budget outlays, object support outranks subject support by a factor of 3:1, although this high ratio reflects in part continuing spending obligation under previous support regimes. A closer overview of basic policy orientations over the past 30 years is given in Box 9 and indicates fairly large fluctuations in the parameters relating to the financing, tax and subsidy framework for housing policy, but without large shifts in the role of government.

In terms of responsibility for implementing policy, the local government sector has a critical role. Municipalities decide on which rent control regime to apply, they have been the force behind establishing housing associations and they have the administrative responsibility for the individual housing support. Municipalities also have the right to requisition 25 per cent of vacancies in social housing, mainly used for recipients of social assistance and thereby integrating housing in their execution of social policy, but also ensuring a steady demand directed at this segment of the housing market. The central government for a long time maintained a system of normative building quotas for social housing as a means both of macroeconomic stabilisation policies and of controlling subsidies on the fiscal budget, the latter purpose supported by limits on construction costs in social housing. These instruments have been abandoned (quotas in social housing in 1994, cost limits from 1997) and responsibility fully delegated to municipalities, only offset by a requirement for a larger municipal share in the financing of social housing, 14 per cent to be paid up front as against 7 per cent before 1998. On the other hand, the main financial responsibility rests with central government, which covers about 85 per cent of transfers to social and cooperative housing and refunds individual housing benefits by 50 per cent for non-pensioners and 75 per cent for pensioners. While municipalities have been required to underwrite in full the loans of housing associations since 1994, the debt relating to the older stock is guaranteed in equal parts between central and local government. Housing policies are thus characterised by a division of administrative from financial responsibility with decisions at local level having significant cost implications for the central government.

Economic impact of government interventions to regulate and support the housing market

Along with social insurance, health and education, the provision of adequate housing may be seen as one of the main planks of welfare state policies in western Europe. The vast array of government interventions to regulate and support the housing market affects overall economic performance in important dimensions: housing has been a dominant investment component; it is a major source of cyclical fluctuations and a heavy expenditure component in household and public budgets; the housing stock is one of a nation's largest capital assets, each vintage rendering services over a century or so and its maintenance, repair and utilisation take on increasing importance. The following section deals with outcomes in these areas and the interaction with incomes and labour-market status.

Declining housing investment

Housing investment reached a historical peak in the early 1970s at close to 10 per cent of GDP. That share fell rapidly to about 3 to 4 per cent in the early 1980s, but for the 1970s as a whole, the Danish investment level was in the upper range in an OECD context [ILLUSTRATION FOR FIGURE 20 OMITTED]. With real interest rates increasing markedly and income growth slowing from the late 1970s, the upward trend in real house prices was broken [ILLUSTRATION FOR FIGURE 21 OMITTED], and housing investment fell. The decline was more pronounced in Denmark than elsewhere, and for the 1990s the share of GDP allocated to housing investments has been among the lowest in the OECD area (with the exception of other Nordic countries) even when the rise in recent years is taken into account. A similar picture arises when considering the share of housing in overall investment. In the 1970s, it accounted for around a third of all investments, but then declined to less than a fifth two decades later. The construction of new dwellings declined from above 50 000 per year in the early 1970s to 17 000 dwellings per year in the 1990-97 period. In parallel, the average size of new dwellings has fallen by more than 50 per cent from its peak in the late 1970s. Housing consumption, which in part reflects actual rents paid, in part the estimated capital consumption of the owner-occupied stock, has increased from 10 per cent of GDP in the early 1970s to about 14 per cent in the early 1990s (Table 17). Despite the reduction in resources committed to housing during the past few decades, Denmark has on the whole been able to maintain an overall favourable position relative to other countries in terms of the availability and quality of housing.

Table 17. Housing consumption relative to GDP(1)

Per cent

	1970	1980	1996
Denmark	10.3	14.6	13.5
Finland	9.8	9.7	13.0
France	8.8	10.2	13.5
Germany	8.7	10.6	11.2
Netherlands	8.2(2)	9.3	12.3
Norway	10.0(3)	9.5	10.2
Sweden	11.3	12.5	16.9
United Kingdom	11.0	11.7	12.3
United States	13.1	14.9	13.7

1. Gross rent inclusive of fuel, etc.

2. 1977

3. 1978.

Source. OECD, National Accounts.

Impact on public finances

The composition of investment reflects the different incentive frameworks facing the four housing segments. Investment in the owner-occupied segment is fully decentralised with owners adjusting to the prevailing tax

treatment of capital income in general and housing in particular. Supported housing in the social rental and the co-operative segment have been subject to annual quotas imposed by central government, a system recently abandoned in favour of a more decentralised approach. The resulting user costs facing residents in the owner-occupied, social rental and co-operative segments, entails for 1998 annual subsidies around 2 per cent (compared with a social cost of 4 1/2 per cent) for all segments with owner-occupied somewhat below the others(49) (Table 18). Government support has fallen markedly from the early 1980s, reflecting the strong fall in inflation and lower marginal tax rates. The decline is most pronounced for the owner-occupied segment which will see a further reduction with the 1998-2002 tax reform.

Following from the above policy framework, housing has been a significant item on the expenditure side of the general government budget, with direct subsidies in 1998 amounting to about DKr 16 billion, or 3 per cent of overall expenditure. When the indirect support through tax revenues foregone is added, at close to DKr 20 billion in recent years, total support approaches DKr 35 billion or 3 per cent of GDP (Table 19). This would nevertheless imply a marked decline from the early 1980s when tax expenditures alone amounted to 4 to 5 per cent of [TABULAR DATA FOR TABLE 18 OMITTED] GDP. The scope for further reduction deriving from lower interest rates is diminishing rapidly, but the tax value of interest payments deductibility is set to fall further with the tax reform for the 1998-2002 period. Within the present framework, the main component continuing to drive public expenditures is the individual housing benefit, which currently reflects efforts to have pensioners taking up residence in specialised individual houses for the elderly now being built rather than moving into an institution. Some years ahead this will be reinforced by a demographically-determined increase in the number of (more affluent and therefore less eligible) pensioners. The continuous upward trend can be expected to continue, all the more so since take-up rates of benefit appear to be increasing steadily while not yet approaching saturation. On the most recent count, such rates are 91 per cent for pensioners and 78 per cent for non-pensioners.(50)

[TABULAR DATA FOR TABLE 19 OMITTED]

A highly cyclical housing market with strong repercussions throughout the economy

The housing market is crucial to an understanding of the cyclical development of the Danish economy. Prices for owner-occupied housing were on a continuous upward trend during the 1960s and 1970s, when the annual nominal change differed between 0 and 20 per cent but never became negative. This trend was broken in the late 1970s when house prices fell by 9 per cent from 1979 to 1982, and the strong rebound in prices up to 1986 was fully offset during the 1987-1993 period. Prices in the owner-occupied market were fed by and fed into a strong macroeconomic performance over the 1993-1998 period, but in real terms housing prices had not yet reached previous peaks ([ILLUSTRATION FOR FIGURE 22 OMITTED], panel A). Transactions in this market show a pro-cyclical trend with sales increasing and bankruptcy proceedings falling when prices are on the rise (panel B). Moreover, housing investment in Denmark would appear to conform to a Tobin's Q model for investment whereby construction of new houses picks up when prices in the second-hand market approach and eventually exceed the construction costs associated with a new house. As the housing stock adjusts to the new equilibrium, housing starts will again fall (panels A and C). Finally, housing wealth is by far the dominant component of household wealth and changes in this component will feed strongly into private consumption. Danish consumption functions typically embody a 10 per cent short-term impact on private consumption from a given increase in the real housing wealth, implying that over the 1993-97 period about one-third of the increase in private consumption can be attributed to the increase in house prices.

The Danish experience of large annual changes in house prices seems to be the international rule rather than the exception, with a number of countries having seen even larger nominal annual increases and declines, both as extreme observations and as an average ([ILLUSTRATION FOR FIGURE 23 OMITTED], panel A). Denmark appears to have a more parallel development in house prices, consumer prices and disposable incomes than most other countries (panel B). But house prices appear to have a fairly large effect on the domestic economy insofar as the Danish economy exhibits an internationally large variation in housing investment, which as noted above can be traced directly to variations in house prices (panel C). There would also appear to be a far stronger correlation between house prices and private consumption in Denmark than in most other countries (Table 20), despite an internationally-low real household wealth relative to GDP.

A variety of factors may serve to explain the apparent volatility of prices and transactions in the housing market compared with markets for other goods and services. Housing demand depends on both the underlying demand for housing services and the asset accumulation embedded in the property stock. From Danish evidence, the income elasticity of housing demand was as high as 2 [TABULAR DATA FOR TABLE 20 OMITTED] in the 1960-70 period, when real house prices were increasing strongly, but it has since fallen to about unity. However, with the annual increase in housing supply failing to surpass I per cent even in years with a high investment level, changes in underlying demand induced by changes in interest rates and taxation of capital income or in income expectations will in the short run mainly affect prices. These will then converge to a long-term equilibrium level - determined by construction costs for new houses and land prices - as new supply is brought on the market.(51) In the Danish case, changes in housing demand have quite divergent effects in the rental and owner-occupied segments with basically the length of the queues being affected in the two rental segments, while both prices and investment volumes respond in the non-regulated owner-occupied segment.(52) Indeed, responses in the non-regulated sector will be correspondingly stronger due to the overflow to and from the regulated segments.

Forward-looking behaviour on the part of market participants may in principle limit the amplitude of the cycles in house prices. But substantial transactions costs, reflecting high direct and indirect cost of moving(53) and stamp duties and other levies imposed by government, restrict the range for price arbitrage and contribute to slow adjustment. Similar effects arise from information problems as house owners typically undertake very few transactions over a lifetime and are often restricted by financing constraints. If anything, the pattern of transactions in the Danish housing market appears to strengthen fluctuations. As noted, purchases tend to follow a pro-cyclical pattern, with transactions increasing once prices can be shown to be on the rise; this applies in particular to first-time entrance into the owner-occupied sector. Crucial to this behaviour is the desire to avoid capital losses - or equally - reap (non-taxable) capital gains.(54) Households are generally highly-geared during the initial years of a mortgage insofar as annuities at fixed nominal interest rates in an inflationary environment imply a high effective amortisation in these years but a rapidly declining real value of the debt and the annual payment thereafter. This mode of finance gives full security with respect to nominal payments, but falling house values may nevertheless force a household to realise heavy capital losses if it is affected by adverse income developments and has to sell. This mechanism has taken on stronger significance in the non-inflationary environment of the late 1980s and 1990s.

Historically, governments have intervened to prolong or reduce the maturity of the mortgage to influence the annual servicing cost of the loans and the gearing level of households. Such interventions relied on the regulation of credit market prevailing at the time and were used repeatedly to stimulate or cool down the owner-occupied housing market (see Box 9). The only channel which remains open to influence loan servicing cost is modifications in the tax system to change the value of the tax-deductibility of interest payments.

Consistent with the overall framework, investment in social and co-operative housing has been based on quotas allocated by the central authorities, but on available evidence, activity in this segment has followed the same course as in the owner-occupied segment. Underlying these demand management interventions have been long-term efforts to increase the level of private savings and secure a more neutral tax treatment of real and financial assets.(55) Also, with falling inflation, borrowers have in general been facing positive real after tax-interest rates. In consequence, housing investment has been on a downward trend, also reflecting more secular forces as smaller cohorts have been entering the market and the demand for basic accommodation has become saturated. However, the cyclicality of the Danish housing market has not subsided over time. House prices have deviated more strongly from construction cost in recent years than fifteen to twenty years ago ([ILLUSTRATION FOR FIGURE 24 OMITTED], panel A). The amplitude of the cycles in housing investment seems not to have increased but it would appear that the correlation between house prices and private consumption has become much more pronounced in recent years (panel B).

Disincentives to efficient utilisation and maintenance of the housing stock

The extensive regulations governing price-setting in the rental housing market have been a recurrent topic in the housing policy debate, with the main criticism attaching to their effect on the utilisation of the housing stock and its maintenance. In both the private and in the social rented segment current rent controls tie rents to either a historically determined level or actual costs at the time of construction. The consequence is a lack of correspondence between actual rents paid and tenants' assessment of location, size and quality as reflected in what they would be willing to pay. Identical apartments may thus fetch quite substantial differences in rents. In the absence of market-based rents, apartments will to a large extent be allocated on the basis of personal connections, queuing and acquisition of seniority rights - which also imposes costs on rental-seekers and introduces a high degree of arbitrariness in the allocation process.(56)

While rents in the private rental segment are only subject to an upper ceiling, implying that they cannot be above market-clearing level, the regulations in force for social rental housing assume a strict adherence to the cost-based principle, which implies that rents may deviate from market-clearing level in both directions. There are potentially significant obstacles to housing and labour market mobility arising out of these deviations from market-based rents. Once a household has obtained a good quality apartment at rents below market-clearing level, there are very few incentives for it to move, even when objective factors such as children moving out or the death of one of the spouses may warrant it. Even if falling income may lead to a change in consumption patterns, housing consumption may be maintained through the high replacement rate in the individual housing subsidy. In addition, the barter and subletting rights of tenants, combined with the non-terminable contracts, allow privileges to be passed on to relatives and friends or alternatively capitalised (through black-market transactions). On the other hand, if rents in social housing are above market-clearing values, the tenants tending to stay on will be those with rents financed by social assistance. Finally, the queuing system implies that new arrivals to the larger urban areas may encounter significant problems when looking for readily available and affordable rental housing.

Ensuring a closer correspondence between rents and quality was the main objective of the policy shift in the late 1960s. In broad terms, for both private and social rented housing an equalisation across and within vintages of rental housing constructed before the early 1970s was achieved. When this policy was abandoned, the new set of regulations imposed allowed new discrepancies to emerge between pre-1974 vintages and later vintages and within the new vintages. For the private rented segment, the problem is concentrated mainly on the early vintages, reflecting both the basically pre-war origin of the stock and the less restrictive formulation of the rent regulation for vintages dating from the mid-1970s and later (Table 21). In all, it is estimated that 80 per cent of

all rents in regulated municipalities are below market-based rents with the regulation having the strongest effect in the larger urban areas, where alternative housing possibilities are more limited and prices in the owner-occupied segment accordingly higher.

[TABULAR DATA FOR TABLE 21 OMITTED]

For social housing, which has seen significant additions to the stock until recently, rent discrepancies have continued to appear between post-1974 vintages [ILLUSTRATION FOR FIGURE 25 OMITTED] and within each vintage, reflecting the strict adherence to cost-based rents and the dominance of capital costs among total costs. The high inflation during the 1970s and 1980s led to significant increases in nominal construction costs and the effects on ensuing vintages were magnified by the only partial inflation adjustment of loan-servicing costs on index bonds. The low-inflation environment of the 1990s has reduced the impact of these mechanisms, but with the present regulatory set-up rent discrepancies in social housing will remain within the existing stock and emerge with new vintages. In an environment of continued economic expansion and increasing housing demand, housing associations may keep vacancies fairly low, but with more adverse economic developments their revenues may suffer as vacancies increase strongly in the low-quality/high-rent segment. This may have potential knock-on effects on the finances of municipalities which have guaranteed their debt.

The private rental sector accounts for the largest share of sub-standard dwellings, not only because this stock is concentrated on older vintages, but because economic incentives for maintenance and standard improvement have been far from sufficient. The depreciation allowances built into the accounting regulations(57) imply a rate of return below long-term interest rates for all standard improvements with the exception of technical installations. In total, the regulations have combined to produce a back-log of maintenance work of about DKr 12 billion (1989-prices) for the pre-1950 stock. The strong increase in maintenance charges in the years 1994-98 has been sufficient to maintain the quality of the stock, and is in the assessment of the Danish authorities starting to make inroads into the back-log of maintenance work. With the large backlog at hand, it was left to public authorities to seek to re-dress this neglect with the reinforcement of the urban renewal programme in the early 1990s with accumulated total costs over the present decade of close to DKr 18 billion, of which DKr 11 to 12 billion will be reimbursed by public authorities (Box 10). Indeed, one of the main lessons to be drawn from the experiences of Denmark and many other European countries is that rent controls, most often without proper regard for incentives to maintenance, have serious long-term effects on the quality of the relevant housing stock, in the end necessitating heavy government outlays to offset the deterioration of the capital stock.(58)

Equally important, policies pursued vis-a-vis the private rented segment have severely restricted consumer choice, with the stock declining and not more than 3 000 new dwellings for private rental coming on the market each year. This is an outcome of the configuration of government support through transfers and tax expenditures which has channelled housing demand into the owner-occupied and social rented segment. The ex-post return from investing in private rental housing for an investor liable to personal income taxes has been above that from long-term bonds, but this premium reflects the nominal capital gains achieved generally in the housing market in recent decades. Indeed, an expectation of a dismantling of rent controls seems to have been incorporated in property prices in this segment insofar as the return arising from operating the property is below the yield of the financial investment. With capital gains being taxed for investors liable to corporate taxation, financial investments in long-term bonds have in general been more favourable. As a result, investment in rental property has mainly been carried out by tax-favoured investors such as pension funds and life-insurance companies.

Finally, rent control will also give rise to spill-over effects on prices in the other segments, insofar as the restricted supply of rented properties forces potential tenants over into the other segments. If relocation into social housing is disregarded and owner-occupied housing is seen as the main alternative, the ensuing price premium in the market for owner-occupied housing has been calculated at 40 to 60 per cent in the Copenhagen metropolitan area, and at 10 to 15 per cent in the other metropolitan areas where rent control is seen as particularly effective(59) (Table 22). These premia decline rapidly if the degree of substitution between owner-occupied and rental housing is assumed to be less than perfect due to a preference for the former as a source of wealth accumulation, etc. In terms of housing policy, rent control acts not only as an impediment to supply in the controlled segment, it has also conferred additional capital gains on those having established themselves early as owner-occupiers in the major metropolitan [ILLUSTRATION FOR FIGURE 22 OMITTED] areas. it has also increased the costs to those households now wanting to establish themselves in those areas.

Cost levels in supplier sectors are on the high side

More generally, the generous subsidies conferred upon the Danish housing sector raise the issue of who actually receives the benefit: whether such subsidies end up as higher wage levels and lower productivity in construction, as higher remuneration for real estate agents and other providers of services to this sector, or as more generous spreads for financing institutions. The outcome depends crucially upon the competitive structures, and services catering to housing typically operate in a sheltered environment. However, competition in the construction market has benefited from the integrated Nordic labour market, in existence for more than 40 years, and has strengthened further with the internal-market programme of the European Union. More important for housing has probably been the concentration of suppliers in small enterprises and self-employed. On the whole, there are few signs of insufficient competition in the construction sector, if measured either by mark-ups or profit rates or in terms of wage premia,(60) and the market structure does not reveal any dominant actors on a national level. On the other hand, the rate of new entrants is fairly low, and a prevalence of price agreements and licensing agreements for some professions, such as electricians and plumbers, can be observed. Together with the perceived high cost of public construction and urban renewals, this has led to the appointment of a government committee looking into the competitive structure of the sector.

Up to 1997, the rules for financing social housing stipulated a fixed construction cost per square metre, regulated annually by the increase in the net price index, and which was the basis for subsidies from the central government. Cost increases beyond this level had to be covered by local authorities. From 1998, this ceiling has been removed, with the incentive for cost control at local level stemming mainly from the 14 per cent financing contribution put up by local authorities. It remains to be seen whether this system improves incentives compared with its predecessor, which arguably removed incentives for competitive price bidding insofar as private entrepreneurs could have designed their offers to meet the maximum price and not to offer the cheapest alternative. Reflecting the strong variety of costs in urban renewal projects, both at a given point in time and over time, cost norms have not been imposed upon this sector, the main incentive to cost control emanating from the fairly high marginal share for local government.

In other supplier services, a substantial degree of vertical integration can be observed between estate-agents, mortgage institutions and insurance companies, possibly yielding efficiency effects that may serve to lower costs, but on the other hand restricting consumers' choice. From an international perspective, transaction costs do not appear particular high,(61) even when those imposed by government are disregarded ([ILLUSTRATION FOR FIGURE 26 OMITTED], panel A). Of particular significance is the width and depth of the Danish mortgage market which should serve to uphold competition, implying that a return to bondholders above their required rate of return will rapidly be competed away. Nevertheless, by international comparison, cost levels in

the Danish housing sector appear to be on the high side, particularly for investment (panels B and C). Producing purchasing power parities for housing are fraught with larger difficulties than in most other areas and differences in taxation of housing further complicates cross-country comparisons. But on the available evidence, cost levels in Danish housing do not seem to be converging towards that of other European countries.

The distributional outcome: concentration of economic resources

The perceived economic advantage enjoyed by owner-occupiers relative to other tenures has had strong effects on the distribution of households among the four main housing segments. In a period of increasing real incomes and the emergence of the two-income family, married and cohabiting couples have been leaving the rented segments at a rapid pace. Multi-person households have fallen over the 1970-1991 period from 57 to 37 per cent of residents in the private rented segment and from 69 to 40 per cent in social housing, while remaining above 75 per cent of owner-occupied housing (Table 23). The rented segments have over time moved towards a stronger representation of persons below 35 years of age. The elderly (above 65 years of age) have become in absolute terms the largest group in these segments, which would seem to point towards strong cohort effects and a certain tendency to move out of owner-occupied houses sometime during retirement. These compositional changes were most significant during the [TABULAR DATA FOR TABLE 23 OMITTED] 1970s, the pace of change subsiding markedly in the 1980s. Nevertheless, it has grafted onto the housing stock a strong segmentation, with economic resources concentrated in the owner-occupied segments. Those with stable labour-market relations belonging to high-income groups live predominately in owner-occupied houses.(62) Low-income groups with high unemployment risk or outside the labour market - immigrants being a prime example - live predominantly in rental housing and have increased their representation in social housing. In this respect, the redistributive argument often put forward in favour of rationing by queuing instead of by market-clearing prices is gradually being eroded. Privileges once obtained in a queuing system can be passed on by means of the right to sub-let and barter in private rentals and seniority or inherited membership in housing associations.

Segmentation effects have been a central policy focus in most European countries in recent decades, as they tend to coincide with an aggravation of social problems.(63) In the Danish case, the segmentation occurred during a period of declining overall income differentials, but with increasing benefit-dependence among marginal groups in the labour market.(64) The fact that property rights conferred upon the owner-occupied segment give rise to increases in capital value, either from general price increases, from efforts to maintain and improve the property and from an overall favourable tax treatment of this segment, has reinforced this segmentation. Other mechanisms which continue to act to maintain segregation are also in play. The back-log of maintenance in private rented housing is one example, the existence of negative "rent discrepancies" in social housing another.

Against this background, the housing benefit has been the main instrument to ensure that short-term distributional objectives are observed. As noted above, its actual coverage is rather extensive (22 per cent of all households), and its potential even higher: as many as three-quarters of all tenants could qualify under the income eligibility criteria imposed. In its mid-1990s formulation, pensioners received a far higher average support (65 per cent) than non-pensioners, reflecting primarily a higher level of support for a given set of incomes and rent levels. While this feature would seem the major inefficiency from a distributional point of view, inefficiencies also arise within each set of recipients. For non-pensioners, about 10 per cent of recipients in 1992 had gross taxable incomes above the level of the average production worker (APW) and in terms of disposable income, the average support received did not show any tendency to decline with incomes(65) [ILLUSTRATION FOR FIGURE 27 OMITTED]. For pensioners, 12 per cent of recipients had incomes above

two-thirds of the APW level, with the average support being more or less constant across intervals of disposable income.(66) Following the high marginal support rates, the scheme has more or less automatically accommodated higher rents while the distributional impact has seemed unclear. From an international perspective, the Danish housing benefit appears to have a wider scope than most other countries [ILLUSTRATION FOR FIGURE 28 OMITTED].

Effects on labour market efficiency are hard to disentangle

The means-tested individual housing subsidy combines with the tax system and means-testing of child-care fees to produce very high effective marginal tax rates, both on labour supply and on savings. The tapering-off in the Danish housing benefit is rather slow, reflecting a withdrawal of benefits over a fairly wide income range, with values between 12 and 20 per cent for non-pensioners. But it comes on top of already-high marginal income tax rates [ILLUSTRATION FOR FIGURE 29 OMITTED]. In particular, single-parent households face effective marginal tax rates of more than 50 per cent in all income brackets above one-third APW. Pensioners are faced with marginal tax rates for additional income ranging from 50 to 80 per cent, which may affect their savings behaviour, or equally, labour supply during the working age. If marginal tax rates above 70 per cent are seen as constituting a poverty trap, about 43 000 working-age families (out of a total of 2.0 million) appear to be affected, For pensioners about 43 000 families (out of 0.8 million) are affected. By implication, stronger means-testing of housing benefits (higher tapers across a shorter income interval) may risk taking a substantial number of households into very high effective tax rates; the basic option would seem to be to reduce the overall generosity of the scheme, particularly vis-a-vis pensioners.

The interrelation between housing and labour market mobility is not altogether clear and it has not, at least in the Danish case, been subject to any extensive empirical investigation. By international comparison, Denmark would appear to score above the average with respect to labour market mobility: job tenure is relatively low, job turnover high - about 30 per cent of positions will generally have been filled within the past twelve months and if hiring and re-hiring of unemployed is excluded, 10 to 15 per cent of employees can be expected to change employer each year. Evidence from the late 1980s indicates that only a quarter of all job changes was associated with a change of residence. As can be expected, job mobility was far above the average for the 16 to 30 year age group with an annual propensity to change employer close to 20 per cent and more than one-third of these requiring a change of residence. A well-functioning housing segment catering to the needs of youths during a trial-and-error search process in the labour market would appear to be the main link between housing and labour market mobility, and rental housing would be the closest to fill such needs.

The rented segments also seem to have above-average mobility (Table 24). However, actual housing mobility is caused by a variety of factors and only a few of them can be seen as affecting labour mobility. The queuing system in the rented segments probably contributes to uneconomical mobility, since households are forced to move more often than they would like in order to get a dwelling in accordance with their preferences and incomes. Evidently, youths will be particularly exposed to this mechanism whereby they will often have to pay fairly high initial rents (or accept low-quality housing) to get a foothold onto the housing ladder. On the other hand, rent differentials also produce lock-in effects as those tenants at the top of the ladder which have succeeded in obtaining a high quality apartment at a low rent, have few incentives to move. With price regulations channelling housing demand into the owner-occupied segment, overall mobility also falls insofar as transactions costs are significantly higher in the owner-occupied segment than in rented housing, generally in the proportion 6:1.(67) In the owner-occupied segment, the predominance of long-term mortgage financing at fixed nominal rates allows owners to continue to service their debt even during periods of rising interest rates. The induced decline in house prices will for the same reason only affect those with significant negative shocks

to their income and therefore being forced to sell. Compared with countries with financing at variable rates where higher interest rates will affect both the annual cash flow and the value of the collateral, the Danish mortgage system would appear to reduce the number of forced sales and repossessions and thus lower uneconomical mobility. The main avenues to improve economically advantageous housing mobility thus seems to lie with the level of transactions costs and the allocation mechanisms in the rental segments. Indeed, a more market-oriented [TABULAR DATA FOR TABLE 24 OMITTED] allocation process in the rented segments can be expected to improve labour mobility. Although empirical evidence from Denmark is not available, studies for other countries indicate that a well-functioning rental market is the main link between housing and labour mobility.(68)

In sum

The substantial amounts of private and public resources channelled into housing in recent decades have served to extend and improve the quality of the housing stock from what was a high level at the outset. However, the framework for decision-making has served to impair the efficient use of these resources from a number of perspectives:

i) the price regulations covering rented private housing have given insufficient incentives to maintain the quality of this segment. The long period of the poor maintenance has left this stock in rather bad shape; as a consequence, urban renewal has become a public responsibility necessitating large outlays;

ii) the stock of available private rented housing is stagnating, with new property for rented housing mainly having been built by tax-privileged sectors;

iii) the lack of correspondence between rents and the quality of housing both in the private rented and social rented segment prevents an efficient allocation of flats for rent and reduces overall mobility;

iv) the owner-occupied segment - which benefits from generous, though declining, tax expenditures - is characterised by fairly large fluctuations in prices, which are fed by and have encouraged a behaviour based on anticipated capital gains and losses; the quota system in use for social and co-operative housing strengthened rather than modified these cycles;

v) government support is a mix of support for investment in bricks and mortar and individual subsidies, with no apparent objectives set out for deciding the balance between the two or between the different segments of the housing stock. Moreover, individual housing support is strongly biased towards old-age pensioners whose position on average compares favourably with that of other households in terms of disposable incomes and wealth.

Scope for further reform

Proposals for a more or less comprehensive market orientation of housing policies have been a recurrent theme of the Danish economic policy debate. Since the flawed 1968-74 reorientation of housing policies, short-term distributional concerns seem to have consistently outweighed arguments based on the need for mobility and market-based incentives to ensure maintenance and expansion of the rental stock. Important changes have nevertheless been effected for the owner-occupied segment with the reduction in inflation and marginal tax rates, a process which is being continued with the recently adopted 1998-2002 tax reform. In housing policies proper, the most important initiatives in recent years lie in the urban renewal programme and decentralisation, with more authority being delegated to municipalities - even though finance is still being provided through targeted programmes rather than through extension of block grants, which would require municipalities to balance housing objectives against other priorities.

Policy signals pointing towards a clarification of objectives and a closer scrutiny of instrument use have nevertheless been emerging:(69)

* The large supply of high-quality dwellings has led to the recognition that there are declining benefits from broad and indiscriminate support and that future real income increases are likely to underpin housing demand even in the absence of subsidies. Consequently, the priority is to shift public support to targets such as housing for elderly and other groups with special needs, with a continued presence in urban renewal.

* Subject to maintaining a reasonable living standard for pensioners, the housing benefit is to be part of a comprehensive review of taxes and transfers, with the aim of strengthening incentives to savings and labour supply.

* Rent regulation is recognised as having entailed a deterioration in the associated housing stock, associated with pronounced disparities between rents paid and the quality of apartments.

* Finally, as a follow-up of the 1998-2002 tax reform, the Government signalled a review of the existing financing system for social housing in order to reduce the associated public cost. Indeed, such a review follows logically from the recently-stated goal of maintaining the relative support levels between housing segments.

Changes in housing policies in 1996 and 1997 having been directed at the formulation of the urban renewal programme and delegation of more responsibilities to municipalities vis-a-vis social housing, late 1998 saw the introduction of two important proposals for modifying the economic parameters facing households and housing associations:

* To hold back rent increases and make households face a larger share of housing consumption expenditures, the housing benefit will cover 60 per cent of a rent increase for non-pensioners (down from 75 per cent), and 75 per cent for pensioners (down from 90 per cent). Housing benefits will be means-tested against households' financial wealth in addition to current income. The reform will be phased in gradually to 2004, reducing expenditures under this scheme by close to 10 per cent.

* The financing of social housing is to be reorganised: i) index bonds will no longer be obligatory and central government will have full discretion in choosing the most favourable financing mode; ii) payments from tenants will be independent of the financing used and determined in relation to construction cost, the present indexing rule (valsetakten) remaining but modified to allow higher rents in old property compared with social housing dating from before the reform; iii) in property built under the new scheme, a fixed share of rents will, when most of their debt has been retired, be transferred to a countrywide fund which will be built up with the aim of taking over central government involvement in social housing. The reform thus aims at making social housing self-financed; however, this will only start with the construction of new social housing from 2030 whereas the reform actually entails somewhat higher government expenditures in the short run.

Analyses presented by a recent expert commission(70) suggest that the effects of abolishing all controls in the private rented segment would on the whole appear to be of manageable proportions (even if none of the Commission members actually supported this proposal). Rents in the regulated part of the stock (85 per cent of the total) would rise by an average of 39 per cent if they were increased to a level comparable with user costs in owner-occupied apartments, and would affect 80 per cent of such apartments. The ensuing increased rent payments, amounting to about 1 per cent of total household disposable income but concentrated among 13 per cent of households, would automatically be offset in part by individual housing subsidies. In this regard, the effects on public finances would be counteracted by increasing property, income and capital gains taxes from landlords, leaving some scope for further compensation if necessary. In practice, the effects would be smaller

than outlined insofar as lower housing demand would reduce the scope for rent increases, and over a somewhat longer horizon the supply of rental housing would pick up.(71) Important from a distributional perspective is the gradual deregulation process envisaged by the commission, implying that rents would only be increased upon relocation, not for an existing contract, and such a protracted process would serve to ease transition problems. In sum, a dismantling of rent controls would serve not only to restore incentives to maintain and utilise this stock more efficiently, it would also provide further impetus to the process of refocusing the individual housing subsidy already started.

In several respects, the rent regulations for social housing would appear to have equally distorting effects. Maintenance has in general been satisfactory, but rent differentials are significant. An alignment of its rent structure with market-based rents, tried at an earlier stage,(72) would have beneficial effects not only for housing mobility and utilisation but also for investment decisions. In terms of incentives, a drawback with the organisation of social and co-operative housing is the scant notice paid to property rights - allowing stakes in such housing to be freely traded - as means of stimulating tenants' interest in the property at their disposal, which is all the more surprising in view of the role played by wealth accumulation in the owner-occupied segment. Introducing market-based prices on such stakes would not appear to be at odds with the basic tenet of finding common solutions to individual and social problems which is deeply embedded in the housing association movement, and problems arising during their introductory phase should not preclude initiatives which may underpin the long-term viability of those segments.(73) From the point of view of economic relativities between housing segments, the municipal property tax introduced for owner-occupiers as a replacement for taxation of imputed rent from housing, could if extended to social housing allow the equal tax treatment of all types of housing and restore relativities. In such a case, the desired differentiation between segments in the housing market could be effected via fewer policy instruments than at present.

Administrative processes also feature prominently in urban renewal. While inner-city renovation policies were for a long time focused on demolition and clearance to make way for new property rather than renewal - provoking a general public resistance in the early 1980s - the tide may very well have turned too far in the opposite direction. From a point of departure where the Danish housing stock is relatively old compared with other countries, the urban renewal effort is concentrated on prolonging the life span of the oldest section, which may not only entail high costs but also conflict with the underlying demand for types of housing, particularly in terms of apartment size. Coming on top of the overall weak incentives to contain the costs in these programmes, the underlying housing demand with respect to type of dwelling and location would be clearer if landlords and tenants faced a marginal financing requirement in urban renewal more in line with other housing.

The owner-occupied segment will have to play a pivotal role in any reassessment of housing policies, because of its actual dominance and its role as an alternative to financial investment in household wealth accumulation. Having achieved a high coverage of housing at the national level, a natural benchmark would be to align the tax treatment of houses even closer to that of financial investments than embedded in the 1998-2002 tax reform. This requires that a proper market-based return to owner-occupied housing be applied. The brick and mortar subsidies allocated to other segments should be reduced in parallel, with the final objective being a reliance on individual housing benefits to secure the desired level of housing consumption for low-income households. From the perspective of the cyclical evolution of the economy, the absence of a capital gains tax appears to have induced an important element of cyclicality into the market. In this respect, it should be noted that the expert commission report preparing the 1994-98 tax reform (Personskatteudvalget) stated that the absence of a capital gains tax applying to housing investment clearly involved a subsidisation of housing investment when the tax system otherwise taxes nominal capital income. Indeed, if housing investment were to

be taxed on a par with financial investment, on a nominal and accrued basis, capital gains and losses would automatically be subject to taxation, potentially reducing price fluctuations in the housing market. Extending the present system of capital income taxation in such a direction would probably be far more effective than combing the present taxation of real incomes from housing with a capital gains tax. A capital gains tax would probably affect only the decision when to enter the housing market for the first time;(74) what is more important in the Danish case is to modify households' propensity to consume out of current capital gains by "borrowing against own equity". For this, an effective tax would need to be on an accrued basis; in this respect the tax assessment of property in Denmark embodies a fairly short lag which allows price increases fairly rapidly to result in tax liabilities. A summary of recommendations covering all segments and policy instruments is provided in Box 11.

Despite a fairly high degree of continuity in housing policies since the mid-1970s the Danish housing market has been characterised by continued structural change and an overall reduction in resources committed of the same order of magnitude as that seen in other OECD countries which have seen far larger shift in the housing policy framework. To a greater extent than in other countries in recent decades, property wealth can no longer be seen as the main inflation-safe investment option; nevertheless, Danish housing policy has discouraged investment in private rented housing, thereby restricting the evolution of a segment which has been highly viable in other countries. A market-oriented regime may be seen as potentially releasing demand and supply which so far have been suppressed, while at the same time contributing to a more balanced long- and short-term development of the economy.

Notes

1. Econometric studies carried out for this survey indicate that the long-term effects of a percentage point smaller output gap is a 3 percentage points decline in export performance.

2. The nine working days conflict implied a loss of about I per cent of all work days. The immediate consequence was a loss of production, which could be made up for through overtime work and additional hiring, but also through higher imports, lower stocks and exports. The total loss of production is estimated by the Danish authorities to be around half of a percentage point of GDP in 1998.

3. The implementation of monetary and exchange rate policy over the 1992-97 period is covered in some detail in Christensen, A.M. and J. Topp (1997), "Monetary policy in Denmark since 1992", in Monetary policy in the Nordic countries: Experiences since 1992, Policy Papers No. 2 from The Bank for International Settlements.

4. The construction of a broadly based financial index for Denmark is documented in Lynggard Hansen, N. (1997), Indeks for de monetaere forhold, in Monetary Review May 1997 from Danmarks Nationalbank.

5. Danish enterprises benefit generally from the internal-market programme of the EU which serves to level the playing field between enterprises across the Union. Denmark has implemented this programme in full. A remaining issue is to what extent Danish enterprises will benefit from being allowed to have their accounts in euros and share capital paid up in euros, the latter implying a two-currency stock exchange. A general overview of policy issues for Denmark arising from the implementation of the EMU is contained in Ministry of Economic Affairs (1998), Danmark uden for euroen and Ministry of Economic Affairs (1998), Denmark and the euro.

6. Danish macroeconomic models embody short-term GDP effects of a given increase in short-term and long-term interest rates in the proportion of 1:6. See Lynggard Hansen, N. (1997), op. cit.

7. See Bayoumi, T. and B. Eichengreen (1992), Shocking aspects of European monetary integration, CEPR Discussion Paper No. 643 and Lynggard Hansen, N. (1997), Samvariationen mellem udbuds- og

eftersporselsstod. Memo, The Economic Council both find that shocks to Denmark and core ERM countries have been symmetrical whereas Jansson, P. (1996), Sverige och den europeiska monetara unionen: hur stor ar sannolikheten art vi drabbas av asymmetriska chocker? Annex 5 to SOU 1996: 158, finds that Denmark like Sweden and the United Kingdom has experienced asymmetric shocks vis-a-vis Germany.

8. It is customary to list four such channels: i) interest rate effects on investment and private consumption; ii) exchange rate impacts on net exports; iii) asset price effects on demand variables; iv) effects on banks' willingness to lend (balance sheet effects). For a more detailed description, see de Bondt, G.I. (1998), Credit and symmetric effects of monetary policy in six EU countries: an overview, DNB Staff reports, De Nederlandsche Bank.

9. See Slok, T. (1997), Er transmissionsmekanismen forskellig i Danmark og Tyskland, in Nationalokonomisk Tidsskrift 1997/2. In a European comparison, Denmark is among a group of countries (France, Italy, Portugal, Spain and Sweden being the others) with a response time of monetary impulses half of that in the other countries (Austria, Belgium, Finland, Germany, the Netherlands, the United Kingdom) but with only half the impact. See Ramaswamy, R. and T. Slok, The real effects of monetary policy in the European Union: What are the differences? IMF Working Paper 97/160.

10. See 1994 OECD Economic Survey of Austria.

11. See Regeringen (1997), Danmark 2005 and Regeringen (1998), Danmark 2005 - mod nye resultater.

12. An analysis of the short-term reaction of municipalities to shocks to their financial situation - defined as differences between planned (budgeted) and actual expenditures and revenues - indicates an asymmetric response, whereby the income response to negative shocks is stronger than the response to positive shocks. As a consequence, local taxes will tend to ratchet upwards over time. See Rattso, I. and P. Tovmo (1998), Local Government response to Shocks in Denmark, in Ministry of Finance (1998), Kommunal Budgetoversigt Januar 1998.

13. Ministry of Finance, Association of Municipalities, Associations of Counties, Municipalities of Copenhagen and Fredriksberg et al (1998), Den kommunale okonomi ar 2005.

14. The government enters into separate agreements with the organisations of the municipalities and of the counties and in addition carries out separate negotiations with Copenhagen and Fredriksberg municipalities, the two latter combining municipal and county functions.

15. The agreements left some scope for tax arbitrage insofar as the municipal tax on land values was left out of the agreement, allowing some municipalities to lower income taxes and raise land taxes and extract the bonus from central government.

16. The savings potential in public transport is documented in chapter III below. See also 1997 Economic Survey of Denmark pp. 54-55 for a documentation of how far outsourcing in local government has come. Christoffersen, H., M. Paldam and L.M. Andersen (1998), Markets and Municipalities - A study of the behaviour of Danish municipalities, AKF Memo investigates the market orientation of municipalities in more detail.

17. From an overall national perspective, the introduction and build-up of occupational pension schemes would appear not to have entailed any increase in national savings, see Finansradet (1998), Opsparing og fremtidig velfaerd.

18. The interaction between public and private pension schemes may produce very high replacement rates: the labour market pension system being developed and the longstanding individual pension scheme (built up with significant tax privileges) may be combined with the de facto universal early retirement benefit.

19. A recent analysis of nominal wage developments indicates that up to end-1997 wage growth could be fully explained by a wage equation estimated on the 1975-95 period; a conclusion also holding when the estimation period is ended in 1992. See Lynggard Hansen, N. (1998), Lonudviklingen i Danmark, Monetary Review 2. quarter 1998 from Danmarks Nationalbank.

20. See Regeringen (1997), Danmark som foregangsland - Danmark 2005, and Regeringen (1998), Danmark som foregangsland - Den okonomiske strategi frem til 2005.

21. See Regeringen (1998), Danmarks nationale handlingsplan for beskaeftigelse.

22. See Regeringen (1997), Et arbejdsmarked for alle.

23. This accords with the findings in Andersen, T. and J. R. Sorensen (1997), Product Market Integration and Labour Market Flexibility, in Danish and Dutch Ministries of Finance (1997), Proceedings for the international workshop: The effects and policy implications of structural adjustment in small open economies, which indicates that Danish wage growth up to the early 1990s has shown relatively small responses to wage growth in other countries. Pedersen, T.V. (1998), Lonmodeller, Nationalokonomisk Tidskrift 1998/1 finds that wage growth in competitor countries has a clear, although incomplete, short-term impact on Danish wage growth, and lower domestic wage growth in recent years than in the late 1980s reflects the lower wage growth abroad.

24. Pedersen, T.V. (1998), pp. cit. documents that wage formation for skilled workers dominates wage developments for unskilled workers with no influence from own-unemployment for the latter group.

25. Close to 100 000 persons with impaired work capacity are presently employed with standard work contracts.

26. See Smith, N. (ed.) (1998), Arbejde, incitamenter og ledighed.

27. The increase may be attributed to the tax reform which lowered tax allowances for transport to work, but it also reflects the economic cycle which to a considerable degree brought low-paid/low-skill workers back into work, thereby increasing the share of such workers among the employed.

28. See The Economic Council (1097), Dansk Okonomi Efterar 1997.

29. See Blondal, S. and S. Scarpetta (1998), The retirement decision in OECD countries, OECD Economics Department Working Papers No. 202. Only Italy, Luxembourg and the Netherlands had higher effective rates than Denmark.

30. For those having transferred to a subsidised job (skanejob) thereby failing to qualify for early retirement at the age of 60, a special early retirement scheme (seniorydelse) has been made available with effect from 1 October 1997.

31. A further documentation is provided in the 1997 Economic Survey of Denmark, pp. 103-114.

32. See Ministries of Education, Research, Labour, Business, Finance, Economic Affairs and the Prime Minister's Office (1998), Kvalitet i uddannelsessystemet.

33. Private rail transport receives higher subsidies per passenger-km than the government-owned provider.

34. The main distributor in the Jutland/Funen region is ELSAM, in Zealand and its surrounding smaller islands it is ELKRAFT. In technical terms, the former network shares characteristics with the Western and Central European network, the latter with the Scandinavian network.

35. See Konkurrencestyrelsen (1998), Konkurrence i energisektoren. The report summarises earlier studies of the effects of a deregulation of the electricity sector, inter alia that contained in The Economic Council (1997), Dansk Okonomi Efterar 1997.

36. See Konkurrencestyrelsen (1908), op. cit.

37. Historically, subsidies have moved from the electricity part to the heating part of the operation as the latter has been in a build-up and establishing phase. Stiffer competition on the electricity side may in the future be offset by higher heating prices.

38. See 2005-udvalget om videreforelse af arbejdsmarkedsreformerne (1998), Status for arbeidsmarkedsreformerne.

39. See 2005-udvalget om videreforelse af arbejdsmarkedsreformerne (1998), Videreforelse af den aktive arbejdsmarkedspolitik.

40. Documentation is provided in Smith, N. (1998), Det effektive, rummelige og trygge danske arbejdsmarked? in Ministry of Labour (1998), Arbejdsmarkedspolitisk arbog 1997.

41. After the finalisation of this report, the early retirement scheme was modified. While an entry age of 60 has been retained, tax stimuli have been introduced to encourage workers to stay on in the labour force and eligibility criteria have been tightened. At the same time, the formal retirement age was lowered from 67 to 65 years of age, but the offset for retirees' labour income in the basic old-age pension has been lowered.

42. See OECD Economic Survey of Denmark 1997, pp. 64-65. An in-depth analysis of the issue is provided in The Economic Council (1997), Dansk Okonomi Efterar 1997.

43. When putting a rental property up for sale the owner is also obliged to offer it to a cooperative of tenants at a price corresponding to what can be raised in the market.

44. Recent assessments of the proper rate applying to the imputed rent indicate a value between 4 and 7 per cent, with estimates at the higher end reflecting the high real rate of return obtained in the 1980s and early 1990s. See Ministry of Finance et al (1996), Skatteudgifter i Danmark.

45. Stamp duties are differentiated between types of transactions and have on a number of occasions been used to regulate the housing market. During late 1997 and 1998, the stamp duty on borrowing against own equity was raised to 5 per cent against a standard rate of 1.5 per cent.

46. The first mortgage institution was established in 1797 and mortgage institutes have since the mid-19th century been predominant in financing real estate in Denmark. Despite periods of substantial losses, all bonds issued have been redeemed.

47. The tax relief given to holders of indexed bonds acts to raise the value at emission thus lowering government expenditure for interest support. This component of tax expenditure, which can be estimated to DKr 1 3/4 billion, is therefore a full substitute for a direct transfer.

48. Housing benefits are paid in full for dwellings up to 65 square metres for single persons, with an extra 20 square metres allowed for each additional member of the household. For tenants, the benefit is a direct cash transfer, owner-occupiers receive loans with the interest rate set at half of the discount rate. For recipients in

co-operative housing 40 per cent of the benefit is cash support, while the rest comes as a loan. Further details are provided in Ministry of Finance el al. (1995), Individuel boligstotte.

49. Comparing subsidy rates across housing segments is rather complicated, given the highly complex financing, taxation and subsidy arrangements pertaining to each segment. More elaborate calculations are available only for 1994, showing for arrangements then prevailing net discounted subsidies relative to construction costs of 70 per cent for social housing, 41 per cent for supported co-operative housing and 29 per cent for owner-occupied housing, and thus implying the same ranking as the more simplified user cost calculations. See Bygge- og Boligstyrelsen (1995), De stottede private andelsboligers vilkar.

50. See Hansen, H. and M.L. Hultin (1997) "Actual and Potential Recipients of Welfare Benefits with a Focus on Housing Benefits 1987-1992", Study No. 4, the Rockwool Foundation Research Unit.

51. The price reaction may differ between a positive and negative demand shock with a more long-drawn price response in the negative case insofar as the annual reduction of the housing stock cannot exceed the actual depreciation of the stock. It can also be argued that information justifying higher prices will feed more rapidly into actual prices than information indicating lower prices. In the first case, both actual and potential owners may register their demand, in the latter case, only the actual owner may influence prices through his behaviour (unlike financial markets, housing markets do not embody the possibility of short-selling). If mortgage institutes withhold repossessed houses from the market and sell them again only at the peak, fluctuations may be dampened but documentation of their behaviour is hard to come by. See Andersen, T.M., H.J. Jacobsen, H.O. Larsen and P.B. Sorensen (1993), Skattepolitikken og ejerboligmarkedet - teori og empiri, Nationalokonomisk Tidsskrift 1993/1.

52. See Ministry of Housing (19881, Boligmarkedet og boligpolitikken - et debatoplaeg, and Vastrup, C. (1996), Det opdelte boligmarked, Festskrift til Anders Olgaard, Tillaegsnummer til Nationalokonomisk Tidsskrift.

53. For a further discussion, see Christoffersen, H., L. Husted and L.E. Rasmussen (1994), AEldre pa boligmarkedet - en analyse af aeldres boforhold og flytninger, AKF report.

54. The housing market has been described as a lottery, where the lottery in the rental market concerns two aspects: whether the applicant gets an apartment; and how the rent is related to its quality and location. The lottery in the owner-occupied segment, on the other hand, revolves around the possibility of getting a non-taxable capital gain, which for the past couple of decades has depended on the timing of entry and exit. See Ministry of Housing (1988), op. tit.

55. See Ministry of Finance (1997), Medium-term Survey 1997 (Finansredegorelse 1997) for a detailed expose.

56. Whereas the social housing sector relies almost exclusively on queuing for first-time entrance and acquisition of seniority rights for moving within an association (which may cover an entire municipality), the private rental sector has no formal rules in force and relies on both mechanisms.

57. Maintenance charges have been standardised, thus not taking into account different quality and maintenance needs within the housing stock. Present owners have not obtained depreciation allowances for undertaking neglected maintenance of earlier owners and depreciation allowances have with few exceptions not been allowed for standard improvements. The possibility to pass on to tenants some of the costs associated with standard improvements has also been restricted with deductions required for the value of existing installations being replaced and the induced savings on maintenance.

58. "There is now extensive empirical evidence that Europe's long run attempts to solve affordability problems through controlled rents have resulted in deteriorated housing quality and entry/access difficulties for the low income households that such policies were intended to benefit." European Parliament, Directorate General for Research, Social affairs Series W-14 (1997), Housing policy in The EU member States.

59. See Andersen, E. and L.E. Rasmussen (1997), Huslejereguleringens betydning for huslejer og ejerboligpriser, Nationalokonomisk Tidsskrift 1997/1.

60. See The Economic Council (1995), The Danish Economy Autumn 1995, Ministry of Finance (1995), Medium-term Survey 1995 (Finansredegorelse 1995) and Ministry of Finance (1997), Medium-term survey 1997 (Finansredegorelse 1997).

61. Ministry of Business and Industry (1997), Boligrapport - Nemmere og billigere at handle bolig.

62. Christoffersen, H. and L.E. Rasmussen (1995), Danskernes bomonster siden 1970, AKF report.

63. For documentation see Ministry of the Interior et al (1994), Rapport fra Byudvalget 1&2.

64. See Christoffersen and Rasmussen, op. tit.

65. Figures showing the relation between housing support and disposable incomes are not available for later years. However, data for housing support by intervals of gross (pre-tax) incomes are available for both 1992 and 1998. In both years, housing support has tended to fall with higher levels of gross incomes. Insofar as this profile has remained basically unaltered between the two years, it can be surmised that the relation between housing support and disposable incomes has also remained much the same. The additional redistribution effected by the housing benefit scheme above that effected by other instruments (taxes and other transfers) is thus fairly weak. This applies to pensioners and non-pensioners alike.

66. Model simulations suggest that a 10 per cent parallel increase in rents and pension incomes increase the individual housing subsidy by 6 per cent, implying that rising living standards in the form of higher income and housing standard lead to higher individual housing subsidy for pensioners. See Ministry of Finance et al. (1995), Individuel boligstotte.

67. Assuming a wage increase of 20 per cent, the costs of moving to a rental apartment are recuperated within six months, whereas three to four years are required upon moving to an owner-occupied house.

68. A discussion with application to the United Kingdom labour and housing market up to the late 1980s is contained in Oxford Bulletin of Economics and Statistics, March 1980 issue. See also Scottish Journal of Political Economy, September 1998 issue.

69. See Ministry of Finance (1997), Perspektiver for den offentlige investeringspolitik, Prime Minister's Office (1998), Godt pa vej - Danmark i der 21. arhundrede. Regeringsgrundlag marts 1998 and Ministry of Finance (1998), Bedre balance.

70. See Ministry of Housing (1997), Lejeforhold. Lejelovskommisionens betaenkning.

71. Using the same data but another methodology, the deviation from market-rent based rents has been assessed to be 20 percentage points or more lower in the most strongly regulated municipalities than assumed in the commission report. See Andersen, E. og L.E. Rasmussen, op. tit.

72. Increases in rents in social housing in the late 1960s and early 1970s were partly channelled into a nationwide fund which handles renewal of this stock and damages on sub-standard buildings arising out of the new techniques and materials often used in the 1960s and 1970s. It has been argued that a change of rent

structures in this segment would be incompatible with the autonomy of housing associations insofar as it would require inter-associational transfers. See Nielsen, G. (1996), Huslejespaend og selvforvaltning, Festskrift til Anders Olgaard, Tillaegsnummer til Nationalokonomisk Tidsskrift.

73. Capital gains arising in the social housing and co-operative segments would have an offset in capital losses in the owner-occupied segment as the former segments become a more attractive investment choice. Prices of shares in such housing would reflect the future rent payments to service the mortgage taken out by the association and restrictions imposed on private dispositions by the collectively-run association.

74. A separate tax on accrued capital gains has a stronger effect than on realised gains but would probably have to be supplemented by a system of tax credits to avoid liquidity problems for households.

Box 1. The Stability and Growth Pact for non-EMU member states

The European Union's Pact for Stability and Growth, finalised at the Amsterdam Summit in June 1997, clarifies the Maastricht Treaty's provision for dealing with "excessive deficits" and provides an institutional framework for its enforcement, in part through strengthened surveillance and co-ordination of economic policies via the annual review of national stability and convergence programmes. With only a few exceptions, the Pact applies to member countries outside the Economic and Monetary Union (EMU) on a par with EMU countries. In November 1998, Denmark presented its first Convergence Programme according to the Stability and Growth Pact.

For all EU countries, the Pact considers a general government deficit above 3 per cent as excessive unless the European Commission judges it to be temporary or there are special circumstances. By temporary is meant that, according to the projections of the Commission, the deficit would fall beneath the 3 per cent threshold in the following year. When a country is judged to be in recession, which is defined as an annual fall in real output (GDP) of at least 0.75 per cent, the Pact will be enforced in a differentiated manner. If economic output in a member country declines by 2 per cent or more - and provided the deficit is temporary - exemption from the procedure is granted automatically. In the event of GDP falling by between 0.75 per cent and 2 per cent, exemption can be granted in special circumstances by the Council of Ministers. The country would need to convince the Council that the economic decline was "exceptional" in terms of its abruptness or in relation to past experience.

In the case of an excessive budget deficit, the Council of Ministers will, on the recommendation of the Commission, propose a course of action for the country. However, as opposed to EMU countries, the Council cannot impose on non-EMU member states a deadline by which corrective action shall be implemented. However, the Council will monitor measures taken and if they are found to be inappropriate they will make further more detailed proposals, which will be published. Again, unlike for EMU member countries, the Council cannot impose economic sanctions on Denmark to make it adhere to the objectives set out.

Box 2 The 1998-2002 tax reform

The changes in the tax system adopted by Parliament in June 1998 made for substantial changes in the taxation both of capital and labour income:

* Marginal tax rates for negative capital incomes (i.e. where interest payments are larger than interest income and dividends received), and accordingly the tax value of deductible interest payments, will be reduced from 40.4/46.4 per cent in 1998 to 32.4 per cent in 2002.

* The maximum tax value of deductibility of contributions to individual pension schemes (kapitalpension) is to be lowered from 58.7 to 43.9 per cent over the same period. The uniform rate applying to taxation of such pensions upon their disbursement remains at 40 per cent.

* The taxation of returns on pension funds (realrenteafgiften) is to be modified, from a taxation of the surplus return above a real rate of 3 1/2 per cent to a proportional tax rate of 26 per cent. Returns on shares are no longer fully exempted but made subject to a 5 per cent tax rate, while (new) property investment is made subject to the standard 26 per cent rate.

* Marginal tax rates for labour income (on the central government tax schedule) are cut by as much as 7 percentage points for low incomes, and typically by 2 percentage points for average and higher incomes. A slower rate of clawback applying to the refund scheme for income-dependent payments in day-care institutions will serve to lower effective marginal tax rates further. On the other hand, the ceiling for marginal tax rates is increased from 58 to 59 per cent.

* The pension contribution to the government-run supplementary pension scheme (ATP), originally applicable only for 1998, is made permanent and turned into an ordinary tax (the link between contribution paid and pension received being broken).

* Taxation of imputed rent on owner-occupied housing as a component of capital income is discontinued and replaced by an equivalent municipal property tax. Revenue will, however, increase over time, as standard allowances will no longer be allowed after the property has been sold to a new owner.

* Green taxes" (energy taxes on oil, natural gas, coal etc. and the consumption tax on petrol) are increased.

The corporate tax rate will be reduced from 34 to 32 per cent, but a proposal to lower it to 26 per cent, with a lower standard depreciation rate as an offsetting factor, is still being discussed.

In terms of revenue effects, the green tax component insures a front-loading, which will lower household disposable incomes. The modification of the income tax schedule will gradually offset this effect but not in full. Private consumption will be affected by the lower tax deduction allowed for interest payments, including the expected capitalisation effect on house prices. The estimate of the Danish authorities is that the effect of the tax reform is to lower house prices over time by about 10 to 15 per cent, and as a result house prices are expected to stabilise in nominal terms.

Box 3. Central-local government fiscal arrangements

With respect to taxes, the framework of central-local fiscal relations allows local governments to set their own income tax rates for households, subject to a tax base that is defined by central government; they also levy land taxes (grundskyld), and from 2000 all property taxes will accrue to local government.

Spending responsibilities are devolved to the local government sector in most spheres, with counties being responsible for health services and secondary education, municipalities for primary education, social services, housing, renovation and public utilities. In social services, health and housing, targeted (ear-marked) subsidies are received from the central government (refusioner), which implies a cost-sharing between the two tiers of government. Refund rates are generally around 50 per cent but may in some areas reach 75 and 100 per cent, implying a rather large division between administrative and financial responsibility in these areas.

Finance is also obtained by block grants which incorporate a general transfer from central to local government (statstilskud) and (from the perspective of each local government entity) the net result of

inter-municipal and inter-county redistribution schemes. However, municipalities are in general allowed to borrow only for activities financed in full by user fees.

In the aggregate, user fees will typically finance a fifth to a quarter of municipal expenditures (15 per cent for counties), while taxes finance close to 60 (70) per cent. Targeted subsidies and block grants make up the rest. Fiscal control is executed through annual agreements between the central government and the organisations of municipalities and counties, an arrangement which has been in force since 1979. In addition, there is extensive redistribution within the local government sector, accomplished by equalisation schemes operating both on the expenditure and the revenue side. Equity objectives also underlie the offer to local government entities, available since 1995, to opt for a guarantee for the tax base to develop in line with the country average.

Box 4. Greater scope for decentralisation in private-sector wage systems

Since the late 1980s, Danish bargaining structures have undergone a transformation to a more decentralised mode. Wage-setting in the private segments of the labour market falls into one of four categories:

* The normal wage area with wages being the sum of a centrally-determined component and a local component, the latter reflecting enterprise, occupational and individual characteristics. Wage increments resulting from bargaining at central level will be fully reflected in wages throughout this area.

* The minimum wage area with wages being the sum of a centrally-determined component and a local component, but with a formal right for enterprises to set centrally-determined increments against local additions. At times it may be agreed centrally that the offset shall be only partial, and enterprises may be hesitant to use the formal right accorded to them.

* The minimum pay area which at central level only specifies a lower limit for pay with actual wages being set locally. Central agreements will thus affect directly only those at minimum pay level, but they may act as a guide for increments awarded elsewhere.

* Fully decentralised pay with no specifications set centrally.

The balance has shifted in favour of fully decentralised pay with its share increasing from 4 to 17 per cent of the LO/DA area, at the expense of the normal wage area with a share falling from 34 to 16 per cent [ILLUSTRATION FOR FIGURE 14 OMITTED]. At the same time, minimum pay has also gained at the expense of minimum wages.

In keeping with the decentralisation, bargaining at central level has gradually changed emphasis to components other than wages paid. Since 1991, a system of labour market pensions has been erected throughout the private sector and annual contributions to be paid in 1999 amount to 5.3 per cent of wages paid in the LO/DA-area, and will elsewhere in the private sector range between 4.8 and 6.6 per cent.

Working time and other non-wage issues are central elements of central bargaining, with the 1998 negotiated agreement in the LO/DA-area containing provisions with respect to an increase of paid holidays and maternity wages. The agreement was rejected in the ballot, and the government intervention to stop the conflict resulted in a further increase in holidays and days off for children's sickness, partially offset by lower pension contributions. These expedients are at odds with the strategy adopted at central trade union level of extending labour market pensions and the Government's aim of increasing the labour supply, and will in the short term add significantly to pressures in the already tight labour market, particularly if copied into other sectors.

Box 5. The quality evaluation of the Danish education system: analysis and recommendations

The analysis identified the main deficiencies as follows:

* The share of the population with an incomplete secondary or only primary education is higher than in countries Denmark naturally compares with, reflecting high drop-out rates above the compulsory level. This is attributed to a complicated education system and insufficient guidance given to education-seekers, amplified by insufficient economic incentives to complete a higher education. More specifically, vocational education at upper-secondary level is not rated highly among youths while their overall skill level often proves to be insufficient for the pursuit of a general education at this level. The latter feature then carries over into tertiary education, and is only made worse by the long pauses often taken before starting higher studies.

* Skill levels in primary education are low, despite its high resource use. Of importance here is the lack of clear objectives for education at this level, combined with the fact that teaching in Danish and mathematics is often provided by teachers without in-depth studies in these subjects.

* Evaluation, of both curricula and teaching (inputs) and of pupils' and students' competences (output), is unsystematical and not being consistently applied throughout the education system.

* There is a proliferation of educational institutions at tertiary level, making Danish institutions far smaller than in other countries and entailing a danger of spreading resources too thinly.

* New graduates are relatively slow to find employment, reflecting a tendency to pursue only a few selected careers closely related to their education and information problems for employers related to the multitude of educations being offered.

The recommendations following from this analysis can be classified under five policy areas:

* Strengthening the basic educational framework at all at levels by i) clarifying objectives in primary education; iii increasing teachers' competence levels in the core curricula; iii) centralising tertiary institutions to reap economies of scale; and iv) systematic evaluation at all levels,

* Reducing the drop-out rate by i) raising entrance criteria to ensure that those admitted will be able to complete an education; ii) strengthening the guidance process; iii) eliminating extensive trial and error processes and tendencies to undertake more than one education at upper secondary level,

* Improving resource use by making teachers' working hours more flexible and strengthen managerial competence in education institutions,

* Lower pass-through by i) adjusting the student grant system; ii) adopting clearer rules for having qualifications recognised when changing educational choice; iii) stimulating direct transition from the ninth year of primary education to upper secondary education, the present tenth year having proved superfluous for most purposes; iv) adjusting entrance criteria to tertiary institutions,

* Improving feed-back from labour market developments to curricula formulation by i) adjusting established lines rather than creating new ones; ii) strengthening the position of outside examiners.

A series of initiatives are under way to respond to these recommendations, giving rise to a set of proposals to Parliament in the autumn of 1998: evaluation and guidance are to be strengthened, the tenth year to be refocused, vocational training renewed and a development programme for upper secondary education in general initiated, entrance criteria to higher education re-emphasises grades achieved and the tertiary education institutions are to be better co-ordinated.

Box 6. Energy production and the environment

Energy production in Denmark relies to high degree on oil and coal as its energy source, implying higher pollution and emission of climate gases than with alternative energy sources such as natural gas and hydro-electric power. The use of more environmentally-friendly production technologies, such as windmills and dual-purpose plants for electricity and urban heating, has been promoted by a quota system whereby all consumers have to purchase energy from "prioritised production" in a fixed proportion to their overall consumption. This provision is one of several Public Service Obligations resting on energy producers, and the cost associated with these PSOs is levied by the operators of the transmission grid as an addition to the pure transmission costs.

The subsidies used to promote prioritised production are thus not explicitly accounted for, but hidden as a tax on consumers of energy with potential inefficiencies arising out of the concession system in use which guarantees an outlet at guaranteed prices for all energy produced in this way. A reorganisation of the Danish energy market along competitive lines should aim for lowering the costs associated with the given environmental objectives:

* Stronger competition will reduce the scope for producers to pass indirect taxes on emission of climate gases onto consumers and intensify the search for modes with lower emissions. In an integration of energy markets across countries the high Danish taxes may put Danish producers at a disadvantage which has prompted a recycling of the revenue from the C[O.sub.2] tax back to enterprises, in practice leaving the large emitters paying very little for their emissions. Taxes on energy use at the consumption level should be neutral between producers but come at a cost of somewhat lower effectiveness.

* The cost associated with the present set-up would improve with a consistent use of subsidies to prioritised production, a system partly in use for windmills. If the subsidies were matched by higher indirect taxes to neutralise the effect on public finances, the cost of present polices would be fully transparent. With 40 per cent of energy production coming from such producers, the gross flows involved may be impracticable to implement from a public finance perspective. Incentives would nevertheless improve if emission quotas were introduced with a large initial allocation to prioritised producers - taking into account differences in their production technology - and made tradeable.

* Even if the quota system were to be maintained, competition among prioritised producers could be introduced to improve efficiency. The ensuing two-price system for energy would also serve to improve the transparency of energy and environmental policy.

Denmark has taken on extensive obligations under the implementation of the commitment of the European Union under the Kyoto agreement on reduced emission of climate gases, and is committed to a reduction of 21 per cent by no later than 2012. In this perspective, formulating and implementing cost-effective policies are of the utmost urgency.

Box 7. Developing the instruments of labour market policies

While the reform programme has sewed to sharpen instrument formulation and use with beneficial effects on key labour market indicators, scope remains for further strengthening their impact:

* By common consent, the strict UI benefit regime for youths without a qualifying education has been highly successful in stimulating their labour market integration and the present age-limit of 25 years could beneficially be increased to include the 25-29 year age group or low-qualified more generally.

* The combination of a work-for-benefit principle applying to the total earnings of activated unemployed with often high bargained hourly wages for subsidised jobs reduce the job experience gained through activation. The requirement for bargained wages should be alleviated to strengthen the activation programme.

* The planned reform of the UI benefit scheme should incorporate the following modifications: branches with strong seasonal variations (construction, tourism) receives an implicit wage subsidy through the short time-span prior to unemployment used for calculating the benefit level, and the eligibility requirement may be modified to offset this. More fundamentally, the share of expenses covered by contributions from the social partners could be increased to a level where it affects their behaviour, even more so if it were to incorporate elements of experience-rating. [n parallel, job search may be stimulated by the introduction of a replacement rate which may retain its present level for shorter unemployment spans but then starts to decline some time into the spell.

In the interface between labour market policies and social insurance schemes, labour market performance would improve if:

* The disability pension in its Danish version were to be developed into a transitory benefit for most of its participants with wage subsidies to offset cost disadvantages of workers with reduced work capacity during their reintegration into work.

* The formulation of early retirement were to be modified to leave more scope for combining transfer and part-time work. Moreover, labour-supply and effective retirement-age considerations warrant an overall tightening of the scheme which makes it more profitable to continue to work closer to the formal retirement age.

Box 9. Housing policy over the past three decades

The instrumental structure of housing policy arrived at its present formulation in the early 1980s. However, the actual thrust of housing policy has oscillated over time, depending on the balance between macroeconomic, fiscal and welfare state considerations.

1966-74: an unsuccessful market orientation

* The 1966 housing policy package was aimed at removing rent controls in the two rented segments. It contained the following measures: a gradual rent increase to market levels over eight years; government transfers to cover in full interest payments in social housing above a rate of 6 1/2 per cent, a rate which was assumed to emerge as a market rate of interest at the end of the eight-year period; individual housing benefits; a doubling of the rate of return assumed for the imputed rent to 4 per cent and the possibility of converting private rented property to condominiums.

1975-82: struggling with high inflation and high interest rates

* The acceleration of inflation and increase in interest rates made the introduction of market-based rents politically unfeasible. The 1975 policy package then introduced the concept of cost-based rents which was to underlie rent formation both in the private rented and social rented segment. Tenants' barter right was introduced. The subsidy to social housing was modified to a four-year period with full elimination of interest rates above 6 1/2 per cent to be followed by a gradual phasing out of the subsidy. In addition, there was a lowering of the value of imputed rent with a further fall effected in 1978, resulting in values of 2 or 3 per cent depending on the acquisition date.

* In 1976 the possibility of conversion to condominiums was restricted to rentals above a certain standard, and the possibility to convert private rental housing into co-operative housing was introduced.

* Construction of social housing fell in the wake of the phasing-out scheme introduced in 1975, and the rule capping the annual increase in the rent in this segment to three-quarters of the annual inflation rate (valsetakten) was introduced in 1979. It was followed by individual housing benefits for pensioners in the same year.

* Indexed bonds were introduced in 1982 to finance construction in all housing segments as well as business investment in structures. Subsidy schemes for social and co-operative housing were modified accordingly.

1985-89: cooling down an overheated housing market

* The imputed rent was modified in 1985, with a rate of 2.5 per cent applying below a certain threshold, 7.5 per cent above the threshold.

* The 1987 tax reform brought the marginal tax rate for capital expenses down to 50 to 55 per cent or lower, implying as much as a doubling of after-tax interest rates for those previously facing marginal rates above 70 per cent. Central elements in the tightening of economic policy in 1987 (kartoffelkuren) were a tax surcharge of 20 per cent on consumer borrowing and extensive use of regulations of the mortgage market.

1990-94: reviving the housing market

* As a consequence of the prolonged depression in the housing market, the annual commitment quota of the urban renewal programme increased from about DKr 1 1/2 billion in the late 1980s to more than DKr 3 billion in 1993; it was supplemented by a four-year (1991-94) programme of substantial government refunds for maintenance and standard improvements.

* The 1994-98 tax reform continued to lower marginal tax rates for capital income, reducing the tax value of deductible interest payments to typically 46 per cent. The value of imputed rent was lowered to 2.0 per cent (and to 6.0 per cent above the threshold) to offset the lower tax value of deductible interest payments and capitalisation effects on house prices.

* In 1994, the regulations for rent control were modified with an increase in the maintenance charge to offset an accumulated backlog of repairs on old rental property.

Intervention through the mortgage market

After the government withdrew from direct participation in housing finance in the late 1950s, mortgage institutes have dominated this market and interventions to stimulate or restrain housing investment have been effected through changes in the regulations of their lending practices/parameters, particularly for nominal bonds which have always been the preferred mode of financing owner-occupied and private rental property. In broad terms, the regulations have made a distinction between as many as five different categories of lending: i) construction of new houses; ii) for maintenance; iii) additions/quality improvements; iv) purchase of existing houses ("second-hand transactions"); v) loan extensions ("borrowing against own equity"). The manipulation of these regulations has gradually diminished in effectiveness and has become dependent on concomitant modifications of the tax system to have any effect.

* Excess demand during the 1970s was restrained by a loan-to-value ratio for second-hand transactions and loan extensions at 30 per cent and with maturities at twenty and ten years respectively, while new constructions had a loan-to-value ratio of 80 per cent and a maximum maturity of thirty years.

* During the period of high nominal interest rates in the late 1970s and early 1980s, mortgage institutes were allowed to issue so-called cash loans which transform capital losses to tax-deductible interest payments,

thereby lowering the after-tax interest rate for borrowers (coupon rates never exceeded 12 per cent even when effective yields were 20 per cent or morel. Issuance of such bonds was discontinued in 1985.

* In tandem with the introduction of index-bond financing in 1982, the maximum loan-to-value ratio for existing houses was increased to 80 per cent. The ratio was lowered to 70 per cent in 1985.

* The 1986 policy package de facto required long-term financing of both new and existing houses with twenty years mixed loans consisting of 60 per cent annuity loans and 40 per cent serial loans to bring forward in time the cost of servicing the loan. The loan-to-value ratio was harmonised across categories at 80 per cent, the only exception being loan extensions with a ratio of 40 per cent.

* The housing market remained depressed during the late 1980s and early 1990s. Against this background, the maximum maturity was extended to thirty years for all categories during 1990-91, with exception for loan extensions which only followed suit after the distinction between purpose criteria of the loans was abolished in 1992.

* In 1993, the requirement for mixed loans was removed and cash loans reintroduced while - exceptionally but maintained until the end of 1995 - capital losses related to the older stock of cash loans remained tax deductible even after their conversion. This added strength to the conversion of high-yielding bonds to lower yields in late 1993 and early 1994 when market rates fell substantially below coupon rates on the outstanding stock.

Box 10. The Danish urban renewal programme

The urban renewal programme was established in the 1980s, and increased strongly in scope in the early 1990s with total investment now amounting to DKr 2 billion annually. The purpose of the programme was originally to restore buildings which were poorly maintained or were lacking in amenities where such a renewal would not be undertaken without government support, but has now been extended to comprise renovation of entire areas. Reflecting, perhaps, too high a level of ambition, the housing authorities assessed at an early stage the need for urban renewal at about DKr 100 billion, and during the 1990s, a total of about 40 000 dwellings has been renewed at a total cost of almost DKr 18 billion.(1) This implies an average cost per square metre slightly above DKr 5 000, with 22 per cent of the expenses going to projects with a cost per square metre below DKr 5 000 and 39 per cent going to projects with a per square metre cost of above DKr 10 000. 15 per cent of expenses goes to projects with square metre cost above construction cost of new apartments (DKr 12 000).

Public support is either extended as a direct refund of current expenses incurred (about 20 per cent of the total commitment) or as financing support for the investment outlay. Maintenance expenditures are - if possible - financed via still-available accumulated depreciation allowances, while the rest of total maintenance costs is financed by a loan redeemed by public authorities. In those cases where an investment is undertaken to improve the standard of the property, rents are allowed to be increased by about 5 per cent of the investment outlay. Consequently, the increase in rent covers only a part of the total repayment of the loan. In those cases where the rent increase exceeds a geographically-determined limit, public subsidies will cover the excess amount. based on the regulations applied and projects approved, on average 36 per cent of total investment costs will be covered by central government, 23 per cent by the municipality, 35 per cent by tenants and 7 per cent by landlords.

The high cost level of urban renewal costs may partly be explained by the sometimes substantial investment required to restore the quality of old neglected buildings, some of which are of historical value. On the other hand, the process of setting an overall budget limit for the project before tendering would not appear to enhance

cost control. Most of the urban renewal projects are carried out with the landlord as contractor, for whom the urban renewal project typically replaces and finances maintenance investment that the landlord otherwise would have had to undertake at a later stage to keep up the value of his housing capital. This implies little incentive for the landlord to minimise costs. Neither does the financing scheme outlined above provide many incentives for controlling costs. It is basically up to municipalities, which are fully responsible for all administration and carry a 42 per cent share of marginal costs, to ensure that cost are kept under control. In this respect, renewal projects are subject to municipal approval, allowing local authorities to reject projects unacceptable in terms of cost levels and/or quality, and they may enter into negotiations with landlords requiring a higher contribution on their part.

Underlying the urban renewal programme is a preference for the upgrading and restoration of existing buildings, in part reflecting public resistance to the demolition and new building which manifested itself strongly in the early 1980s. In consequence, the demolition rate has declined from around 0.5 per cent of the housing stock in the 1960s and 1970s to 0.15 per cent in the 1980s, thereby adding to the age of the housing stock, which was already rather high in a European context. This may not be compatible with a market-based outcome; if historical scrapping rates are anything to go by, estimated survival curves for Danish dwellings show very high rates of survival until the age of 80 years followed by a sharp decrease over the next 40 to 50 years.(2) In line with this argument, it is also doubtful whether the small apartments resulting from the urban renewal programme - despite effort to avoid renewing the smallest units ensures an optimal size distribution of the stock of dwellings.

1. Individual housing benefits are also available as an integral part of urban renewal projects with the housing benefit in the first year after renewal amounting to 90 or 80 per cent of the rent increase, depending on whether the new rent exceeds 25 per cent of household income or not. The benefit is then phased out over a period of either nine or (our years. As a consequence, this part of the scheme contains more generous eligibility criteria than the two basic constituent parts.

2. Andersen, E. (1996) Overlevelseskurver for boliger, Festskrift til Anders Olgaard, Tillaegsnummer til Nationalokonomisk Tidsskrift.

Box 11. Recommendations to improve the working of the Danish housing market

The framework for household decision-making has been proven to give rise to strong shifts in housing investment, over the economic cycle and over time, while house prices have remained highly volatile. At the same time, the allocation mechanism in the housing market is heavily distorted by government intervention. Changes in this framework are not easily formulated, given the long-term character of housing investment and the strong capitalisation effects arising in this market, and unless carefully designed and phased in, they may as often as not introduce increased short-term instability.

Building upon a tradition of comprehensive policy packages which gradually phase in changes in instrument use, a reformulation of housing polices is required along the following lines and the following priorities:

I. Dismantle rent controls and extend property rights to improve mobility and maintenance

Rent controls do not apply to property dating from 1992 and later, and 1973-91 vintages have been regulated in a way which allows rents close to market-clearing levels. Maintenance is improving, but it has led to a highly complex set of regulations. With a high average age of private rental property and new supply more

or less absent and with both rental segments characterised by large discrepancies between rents and quality, a deregulation should have high priority:

* Rent controls in the private rented segment should be removed, allowing rents to reflect underlying differences in quality and preferences so as to stimulate maintenance and standard improvements. Housing mobility as well as availability for first-time entrants would improve.

* Rent regulation in social housing should be modified, to eliminate unwarranted rent differentials within and across vintages.

* The introduction of extended property rights in social and co-operative housing by making stakes freely tradeable would allow these segments to compete on equal terms with the owner-occupied segment for residents across all income brackets.

II. Continue reform of tax and transfer systems to improve resource allocation and improve equity

Even with the tax reform now being phased in and recent proposals to lower housing benefits and move social housing to a self-financed basis in the (very) long run, government expenditures, direct and indirect, to housing are high. Given the average high housing coverage and quality, a further reduction together with a reassessment of the distributional impact is warranted:

* Taxes and implicit subsidies for owner-occupied housing should be rebalanced to ensure a neutral tax treatment of such investments compared with financial investment.

* The tax treatment of owner-occupied property and social and co-operative housing should be equalised, implying an extension of the property tax to the latter segments, with an adjustment of direct subsidies to re-establish earlier parities if that is desired.

* "Object" subsidies would no longer appear warranted and should be phased out; remaining support should be concentrated upon assistance to individuals.

* The housing benefit should be re-evaluated, in order to increase resistance to rent increases, improve its redistributive effect and reduce labour-market and savings disincentives.

* Cost control processes in urban renewal projects need to be improved, inter alia by requiring higher marginal financing from landlords and tenants.

III. Modify the tax system to reduce the contribution of the housing market to macroeconomic instability

The tax system has proved to be the main instrument to improving structures in the housing market:

* Placing the taxation of housing income on a par with income from financial investment, on an accrued and nominal basis, would make government take part in both capital gains and losses, thus reducing variations in households wealth, and could dampen the race for capital gains so evident in the owner-occupied housing market. A fully developed taxation of housing would also he central if extended property rights were to be introduced in other segments.

IV. Continue the decentralisation process

* Following logically from the above, consideration should be given to a complete decentralisation of housing policies if widespread government intervention continues, thereby requiring municipalities to assess housing expenditure against other public priorities.

While a withdrawal of the public sector from the housing market in a number of dimensions would appear warranted, a central short-term priority should be to remove rent controls, and in this respect, a certain deterioration of public finances in the short run to secure distributional objectives may well prove beneficial if the housing market as a whole were to function more efficiently.

Annex I

Fiscal and structural indicators

[TABULAR DATA FOR TABLE A1 OMITTED]

[TABULAR DATA FOR TABLE A2 OMITTED]

[TABULAR DATA FOR TABLE A3 OMITTED]

[TABULAR DATA FOR TABLE A4 OMITTED]

[TABULAR DATA FOR TABLE A5 OMITTED]

Annex II

Chronology of main economic events

1997

April

The government presents its "2005" plan, outlining the economic policy goals to be reached by year 2005. The principal elements are: annual employment growth of above 1 per cent - the equivalent of 240 000 additional jobs over the period - which should bring the unemployment rate to 5 per cent allowing for an increase in the participation rate of about 4 percentage points. Labour supply growth is to be made possible by a reduction in the number of transfer recipients from 35 1/2 to 26 1/2 per cent relative to overall employment. Foreign debt is to be fully repaid while at the same time reducing the public debt-to-GDP ratio from 67 to 40 per cent. C[O.sub.2] emissions are to be cut by 20 per cent compared with the 1988 level.

May

The government enters an agreement with the two left-wing opposition parties in parliament to restrict private consumption to avoid an overheating of the economy and to pursue environmental objectives. The main elements of the packages are: a 10 per cent reduction of public transport charges; the introduction of a "green" car-ownership charge based on fuel consumption; changing the taxation of goods transporting vehicles from a unit taxation to a value taxation; a higher airport tax and an increase in stamp duty on housing transactions from DKr 700 to DKr 1 200.

A new social assistance law contains inter alia rules that stipulate an increase in the age limit from 25 to 30 years below which activation after thirteen weeks on social assistance becomes compulsory.

October

The discount rate, the interest rate on banks' deposit with the central bank, is increased from 3 1/4 per cent to 3 1/2 per cent.

The government agrees with centre-right opposition parties on a fiscal package for 1998 aimed at restricting private consumption. An obligatory pension contribution of I per cent is introduced together with a tax-free

saving scheme for house purchase and an increase in stamp duty on housing transactions from 1.5 to 5 per cent in cases of borrowing against own equity. All measures are temporary and to be discontinued at the end of 1998.

The privatisation of Danish Telecom is completed with the sale of the government's remaining 34.4 per cent share of stocks to an American company, Ameritech, for DKr 21 billion.

December

The 1998 fiscal bill is passed, containing inter alia: higher indirect taxes; a tightening of availability criteria for unemployed who are obliged to seek work outside their previous occupation after six months and to accept daily commuting time of up to four hours; user fees in labour market training (AMU) are abolished; paternity leave is extended by two weeks to a total of four weeks.

1998

March

The results of the general election leave the minority government of Social Democrats and Social Liberals in office.

Wage negotiations between LO (Danish Confederation of Trade Unions) and DA (Danish Employers' Confederation) - covering the manufacturing, the construction and some larger service sectors, or about 30 per cent of the private labour market - are concluded, yielding expected wage increases of about 4 per cent over the coming two years. In particular, the agreement stipulates an increase in employers' pension contribution of 0.9 percentage points in both July 1998 and July 1999, the granting of an additional vacation day and an increase in the minimum pay during maternity leave.

April

The negotiated wage agreement is rejected in a union ballot with 55 per cent no-votes, thus throwing the labour market into the first large-scale conflict since the mid-1980s.

May

The central bank raises the deposit rate by 1/2 percentage point, then later reduces it by 1/4 percentage point, leaving it at 3 3/4 per cent.

Following a strike lasting nine working days, the labour market conflict is settled through government intervention, leading to two additional vacation days and three days leave for child sickness leave (two immediately and an additional one in 1999) - employees not taking all the above days are entitled to an equivalent cash payment. The planned 0.9 percentage point increase in employers' pension contribution is lowered to 0.5 percentage points while a recently-introduced employers' sickness charge is abolished.

The Amsterdam Treaty on the European Union is accepted in a general referendum with 55 per cent in favour.

June

The annual agreement between central government and local government on local government finances is extending to a four-year horizon with the first of such agreements covering 1999-2002. Local income taxes are to remain unchanged and block transfers are adapted to an expenditure growth in public consumption of 1 per cent. Further increases in service levels are to be contingent upon productivity increases. The agreement also introduces bonuses for tax cuts.

The so-called Whitsun package aimed at restricting the private consumption to prevent over-heating of the economy is passed in Parliament. The package contains a tax reform with the main elements to be introduced gradually from 1998 to 2002: a reduction in the tax value of interest payment deductions from between 40 and 46 per cent to an uniform 32 per cent; a reduction in marginal effective tax rates for low-income wage earners, with marginal tax rates on labour income being reduced by as much as 7 per cent and the withdrawal rate of subsidies to day-care of children being lowered. The obligatory pension contribution of 1 per cent of wages is turned into a permanent tax and the income taxation of imputed rent is replaced by an equivalent local government property tax. A proportional tax rate of 26 per cent applying to the return of assets in pension funds and life-insurance companies replaces from 2 000 "the real interest rate" tax, which taxes away the returns above a 3 1/2 per cent real rate. In addition, additional "green" taxes on gasoline, fuel, electricity and natural gas were introduced with revenues equal to 1/2 per cent of GDP.

August

The goals in the government's "2005" plan are adjusted to incorporate economic developments since its publication. The main deviation from the original objectives is a postponement of the full repayment of the foreign debt as the weakening of the current account in 1997-98 only allows a reduction of foreign debt to 10 per cent of GDP by 2005.

September

The central bank raises the deposit rate to 4 1/4 per cent, and the band between the deposit and the repo rate, previously 1/4 percentage point, is increased to 3/4 percentage point.

The Danish government and central bank reaches an agreement with Finance Ministers of euro countries and the European Central Bank about Denmark's participation in the future exchange rate arrangement (called the ERM2) between non-euro EU-member states and the euro area. The agreement narrows the allowed exchange-rate fluctuations around the central euro-krone parity to [+ or -]2 1/4 per cent.

October

The central bank lowers the repo rate by 0.35 percentage point but leaves the deposit rate unchanged.

The government proposes a labour-market reform, containing the following main elements: compulsory activation of the unemployed after twelve months of unemployment (six months for unemployed youths regardless of educational attainment); a special rule allowing 50 to 54 year-olds to receive UI benefits for up to ten years to be revoked; a reduction in the total period of UI benefit and activation from five to four years. In addition, a reform of the unemployment insurance scheme is to be implemented in 2000, incorporating inter alia a modification of the income base for calculating UI benefits.

The government proposes i) a reform of individual housing allowances, aiming to lower expenditures by close to 10 per cent by 2004 when it will be fully phased in; ii) a reform of the financing of social housing, by no longer relying on index-linked bonds as the sole source of financing, making tenants' payments independent of the prevailing interest rate level and raising them relative to present arrangements.

November

The central bank lowers the deposit rate to 4 per cent and the repo rate to 4 1/4 per cent.

Agreement is reached on the 1999 fiscal bill, incorporating the proposals for labour-market and housing-policy reforms. Restrictions on investment in social housing and higher stamp duties on housing transactions are maintained. The early retirement scheme is modified: the entry age of 60 years is maintained,

but tax stimuli are introduced to encourage workers to stay on in the labour force until the formal retirement age of 65 years (previously 67 years). Eligibility criteria are tightened and a separate insurance premium for early retirement is introduced for members of UI funds. Old-age pensioners are encouraged to go on working by lowering the offset for labour income in their basic (non-funded) pension.

December

The central bank lowers the deposit rate to 3 1/2 per cent and the repo rate to 3.95 per cent.

BASIC STATISTICS: INTERNATIONAL COMPARISONS

[TABULAR DATA OMITTED]

EMPLOYMENT OPPORTUNITIES

Economics Department, OECD

The Economics Department of the OECD offers challenging and rewarding opportunities to economists interested in applied policy analysis in an international environment. The Department's concerns extend across the entire field of economic policy analysis, both macroeconomic and microeconomic. Its main task is to provide, for discussion by committees of senior officials from Member countries, documents and papers dealing with current policy concerns. Within this programme of work, three major responsibilities are:

* to prepare regular surveys of the economies of individual Member countries;

* to issue full twice-yearly reviews of the economic situation and prospects of the OECD countries in the context of world economic trends;

* to analyse specific policy issues in a medium-term context for the OECD as a whole, and to a lesser extent for the non-OECD countries.

The documents prepared for these purposes, together with much of the Department's other economic work, appear in published form in the OECD Economic Outlook, OECD Economic Surveys, OECD Economic Studies and the Department's Working Papers series.

The Department maintains a world econometric model, INTERLINK, which plays an important role in the preparation of the policy analyses and twice-yearly projections. The availability of extensive cross-country data bases and good computer resources facilitates comparative empirical analysis, much of which is incorporated into the model.

The Department is made up of about 80 professional economists from a variety of backgrounds and Member countries. Most projects are carried out by small teams and last from four to eighteen months. Within the Department, ideas and points of view are widely discussed; there is a lively professional interchange, and all professional staff have the opportunity to contribute actively to the programme of work.

Skills the Economics Department is looking for:

a) Solid competence in using the tools of both microeconomic and macroeconomic theory to answer policy questions. Experience indicates that this normally requires the equivalent of a Ph.D. in economics or substantial relevant professional experience to compensate for a lower degree.

b) Solid knowledge of economic statistics and quantitative methods; this includes how to identify data, estimate structural relationships, apply basic techniques of time series analysis, and test hypotheses. It is essential to be able to interpret results sensibly in an economic policy context.

c) A keen interest in and extensive knowledge of policy issues, economic developments and their political/social contexts.

d) Interest and experience in analysing questions posed by policy-makers and presenting the results to them effectively and judiciously. Thus, work experience in government agencies or policy research institutions is an advantage.

e) The ability to write clearly, effectively, and to the point. The OECD is a bilingual organisation with French and English as the official languages. Candidates must have excellent knowledge of one of these languages, and some knowledge of the other. Knowledge of other languages might also be an advantage for certain posts.

f) For some posts, expertise in a particular area may be important, but a successful candidate is expected to be able to work on a broader range of topics relevant to the work of the Department. Thus, except in rare cases, the Department does not recruit narrow specialists.

g) The Department works on a tight time schedule with strict deadlines. Moreover, much of the work in the Department is carried out in small groups. Thus, the ability to work with other economists from a variety of cultural and professional backgrounds, to supervise junior staff, and to produce work on time is important.

General information

The salary for recruits depends on educational and professional background. Positions carry a basic salary from FF 318 660 or FF 393 192 for Administrators (economists) and from FF 456 924 for Principal Administrators (senior economists). This may be supplemented by expatriation and/or family allowances, depending on nationality, residence and family situation. Initial appointments are for a fixed term of two to three years.

Vacancies are open to candidates from OECD Member countries. The Organisation seeks to maintain an appropriate balance between female and male staff and among nationals from Member countries.

For further information on employment opportunities in the Economics Department, contact:

Management Support Unit Economics Department OECD 2, rue Andre-Pascal 75775 PARIS CEDEX 16 FRANCE

E-Mail: eco.contact@oecd.org

GRAPHIC: Illustration; Table; Graph
IAC-CREATE-DATE: May 1, 2000
LOAD-DATE: May 02, 2000

Evidentiary Exhibit Number 126

The Sun (Baltimore)

November 29, 1998, Sunday, FINAL EDITION

SECTION: REALSTATE (BUSINESS), Pg. 5L, Mailbag

LENGTH: 569 words

HEADLINE: It helps to know the real estate lingo; Just don't let 'rent to own' or 'buy like rent' lead to 'foreclosure'

BODY:

Dear Mr. Azrael:

There are some real estate terms or phrases that I would like to have defined and explained in more detail. However, I would like to preface those with a brief explanation of my situation.

I am going through a divorce. My wife and I have a first and second mortgage and, while we've agreed that she will get the house (she plans to refinance both mortgages), I have no idea how soon that will happen. My credit is mediocre, at best, and I don't expect to have much for a down payment when I decide to buy a home on my own.

On the other hand, I have been working at the same employer for 10 years now, and I do not want to pay rent any longer than is absolutely necessary.

Having said that, I am wondering if any of the following may be suitable options for me:

Rent to own.

Rent with option to buy.

Owner finance.

Buy like rent.

Co-ops.

Foreclosure.

100 percent financing.

Frederick D. Longhenry

Lutherville

Dear Mr. Longhenry:

You have mediocre credit and little money for a down payment. You will still be liable for the two mortgages on the house your wife gets in your divorce. Rent to own and other options probably will not help you. You need to repair your mediocre credit, so eventually you can qualify for a low down payment loan.

Homes advertised as "rent to own," "buy like rent" and "rent with option to buy" are all rental arrangements.

The lease agreement usually sets a rent that is higher than market. The rent-to-buy lease provides that a portion of the rent will be applied toward a down payment on the house, which the tenant can purchase at a specified price.

Rent/buy arrangements can become very costly for the tenant. A default in paying rent can cause the tenant to lose the right to purchase the home.

The landlord will keep the portion of rent paid toward a down payment. The defaulting tenant will be a big loser. You should carefully review and analyze any rent-to-buy lease before you sign it.

"Owner financing" refers to a sale in which the owner agrees to take back a mortgage for all or part of the purchase price of a property. Often, owners require a down payment. They do not want to finance 100 percent of the purchase price. You may be fortunate to find a home offering 100 percent financing from the owner. This possibility may be your option to purchase a home in the near fu- ture, but you will be lucky to find this opportunity.

"Foreclosures" are sales of property at auction, due to the owners' default in paying their mortgages. Foreclosed properties sometimes can be bought for less than market value, but buyers at foreclosure sales usually need substantial cash to fund their purchases.

"Co-ops" are apartments in buildings that have elected to become "cooperatives." Purchasers can buy the right to live in one of the apartments by purchasing shares of stock in the cooperative. It is difficult to obtain financing to purchase a unit in a cooperative. A substantial cash down payment is usually required.

"Co-ops" also can refer to a division of real estate commission between the broker who lists a home for sale and another broker (the "cooperating broker') who assists in the sale of the property.

The better your credit, the better your chance of getting a loan to purchase a home. Your most sensible option may be to rent for several years until your credit improves.

Pub Date: 11/29/98
TYPE: COLUMN, Q&A, REAL ESTATE
LOAD-DATE: December 2, 1998

Evidentiary Exhibit Number 127

Investor's Business Daily

November 13, 1998

SECTION: Making Money In Mutuals; Pg. B1

LENGTH: 824 words

HEADLINE: Before Becoming A Landlord, Weigh The Pros And Cons

BYLINE: By Dan Moreau, Investor's Business Daily

BODY:

It's a familiar scenario for the adult children of elderly parents. A parent's ill health or even death leaves you with the keys to the family home. Bound by emotion, but staring at the costs for upkeep, property taxes and even a mortgage, you wonder what to do.

Or maybe you've been transferred to a new job and your old house is sitting there with another mortgage payment due any day now. But you don't want to take a bath on a quick sale, especially if the transfer doesn't work and you'll be looking for a place to live.

You'll rent the house, you reason. That way you can have your cake and eat it, too: income from the rent and the option to come back inexpensively. Or you argue to yourself that your parents would have wanted it this way.

But you should weigh the downside before opening up your home to renters. It usually entails a lot more work, expense and headaches than you can imagine.

"I don't recommend becoming a landlord," said financial planner Jeff Metz of Practitioners' Financial Advisers in Cherry Hill, N.J. "Clients I have had in that situation have been very uncomfortable with it. Especially when they lived far away."

Even real estate brokers who have tried long-distance renting caution against it.

"I had a house in Detroit that I rented out and I worried about it from month to month," said Kurt Haaxma, a broker in Alpena, Mich. "I was nervous about being a long-distance landlord."

Come on, now. We're talking about renting a house. Millions do it every day. So how do you pull it off? After all, one of Metz's clients took a job in Boston but kept his house in New Jersey just in case. The job didn't work out and the client went back to his old, familiar home after renting it out for a brief period.

Here are some tips to help you decide whether or not to rent:

First, you have to understand why you want to rent. If it is an emotional attachment to what may have been your childhood home, then decide to keep the house for a limited time, then reassess.

That's what Haaxma did with his father-in-law's house. He and his wife have rented it out for five years since his father-in-law's death.

"We had to look within ourselves and ask, 'Is this a house we are ever likely to live in?' " said Haaxma.

When they realized they would not, they made arrangements to sell it.

If you are considering keeping the house, there is another important consideration, says Judith Lau, a financial planner in Wilmington, Del.

"This is an investment, so you have to ask, What will be the rate of return?" she said. "You compare the rent with what you cosld sell the house for and the rate of return you could get from investing the proceeds somewhere else."

Be sure, she adds, to include all your expenses, such as maintenance, taxes and the value of your time fielding those 3 a.m. phone calls about the heating system that just broke.

If the house needs minor repairs, make them. The better the house, the higher the rent you can charge and the better tenant you will attract. But if the house needs major remodeling, say a new roof or a new heating system, consider selling it as a fixer-upper. It's harder to recover those costs in the rent check.

If you think you will be selling it within a year, leave it empty. Empty houses sell faster and at higher prices than houses with tenants, Haaxma says. Tenants usually aren't motivated to keep the house looking good for potential buyers. If you rent it, make it a month- to-month lease that is easy to end when you sell the house. But remember that problematic tenants can be difficult to evict. Legal actions can take months.

Still game? Here's the last piece of advice. Don't manage the property yourself, especially if you are a long-distance landlord.

The most common source of third-party managers are real estate agents. Many real estate companies offer residential property management for absentee landlords like you. The best of them screen tenants, collect the rent, arrange for maintenance and emergency repairs and evict tenants who don't keep up with the rent checks.

For this, the typical fee is 10% of the rent. Contracts are generally for the term of the rental agreement. Ask for two or three references from any agent you consider. You're looking for agents who buffer you from the management process but keep you informed on the condition of the house.

Good management agents should screen potential tenants and do credit checks on them at your expense. Except in dire emergencies, insist that you approve all expenditures.

Expect that if you replace the manager who found the tenant, but the tenant remains in the house, you will be liable for the original manager's commission each month. If you don't like those terms, Haaxma says, negotiate for more limited liability.

LOAD-DATE: November 13, 1998

Evidentiary Exhibit Number 128

The New York Times

October 16, 1998, Friday, Late Edition - Final

SECTION: Section B; Page 10; Column 1; Metropolitan Desk

LENGTH: 980 words

HEADLINE: Residential Real Estate;
Ruling Broadens Protection for Renter in a Co-op

BYLINE: By DENNIS HEVESI

BODY:

In a decision that could affect the status of unsold co-op and condominium apartments throughout New York State, a housing court judge in Brooklyn has ruled that a tenant who rented an apartment from a sponsor after a conversion was entitled to the same protection against eviction as tenants who were living there at the time of the conversion.

While the ruling's effect is limited for now to the Brooklyn case, some lawyers are worried that it might set a precedent upsetting a standard assumption of the co-op and condominium market: that the sponsor can refuse to renew the lease of a tenant who sublets after a conversion.

The ruling, if upheld, would sharply curtail sponsors' ability to end the tenancy of such renters, preventing co-ops and condominiums from completing conversions while forcing sponsors to keep apartments vacant until they are sold.

"This has the potential of preventing the completion of literally thousands of conversions," said Jim Samson, a lawyer representing about 90 co-op boards in the city. "It would create major economic turmoil in the co-op community."

Stuart Saft, chairman of the Council of New York Cooperatives, concurred. "This case affects every unsold apartment in the city," he said. "It immediately affects all the apartments which the sponsor rented after the conversion, and it will affect every apartment that presently has a rent-regulated tenant as those tenants vacate their apartments.

"When they leave," Mr. Saft said, "the sponsor has to decide whether to sell or deal with giving a new tenant the right to stay forever."

According to Martin Oestreicher, deputy commissioner of the city's Department of Finance, there are at least 420,000 co-op and condominium units in the city, of which about 100,000 are now held by sponsors.

The ruling, in Paikoff v. Harris, was handed down by Judge Marc Finkelstein of Civil Court on Aug. 31. It involved a six-unit co-op, sponsored by Barry Paikoff, at 534 Sixth Avenue in Park Slope.

The tenant, Emil Harris, rented a sponsor-held apartment five years after the 1992 conversion. When the lease expired, Mr. Paikoff started eviction proceedings. But Mr. Harris refused to leave, claiming that he should be considered a "nonpurchasing tenant" under the Martin Act, the state law governing the rights of co-op and condominium tenants. Rent control and rent stabilization are governed by other regulations.

Essentially, tenants protected by the Martin Act cannot be evicted except for good cause, like failing to pay rent, and cannot be subjected to "unconscionable rent increases." The act allows rent-regulated tenants already in the building to retain that status, but does not spell out rent formulas.

Before Judge Finkelstein's decision, it was assumed that only tenants already occupying an apartment during a conversion were protected. People renting after conversion -- either from a tenant-shareholder or a "holder of unsold shares," like the sponsor -- were considered unprotected.

But the judge ruled that the Martin Act applies to any tenant renting from someone other than a "purchaser under the plan." He also ruled that while tenant-shareholders are indeed purchasers under the plan, a holder of unsold shares, like the sponsor, is not -- contrary to a long-held industry assumption that had never been tested in court.

"If the Legislature intended that a holder of unsold shares should be considered a purchaser under the plan," Judge Finkelstein wrote, "the legislation should have contained a provision to that effect."

He also quoted a submission from the State Attorney General's office, which contended that a sponsor is not a purchaser under the plan, and, therefore, "a tenant who rents a vacant unit after the plan's effective date from a sponsor or holder of unsold shares is a nonpurchasing tenant," protected by the Martin Act. On that basis, Judge Finkelstein denied the eviction.

No decision on whether to appeal had been made, said Rand Levin, the sponsor's lawyer. "My view," he said, "is that there is a wealth of legislative history suggesting that the intent of the statute was only to protect tenants in possession at the time of a conversion."

Mr. Harris's lawyer, Ronald Languedoc of Brooklyn Legal Services, called the ruling well reasoned and "clearly reflecting the language of the statute." Mr. Harris, asked if he was aware that his case could set a precedent, said: "I'm very proud of that. Maybe it will give people in my situation a means of stability."

But real estate lawyers said they were concerned.

"Assuming that it's affirmed on appeal, and that's questionable," Mr. Saft said, "it means the sponsor may not be able to sell the apartment in the future because the tenant can't be evicted. From the co-op's point of view, it's good news and bad news. The good news is that it's more likely now that sponsors will sell apartments that become vacant. The bad news is that every tenant who rented after the conversion may have the right to remain permanently."

Mr. Samson, the co-op board lawyer, said he feared that the ruling would give sponsors an excuse to hold on to their apartments and continue collecting free-market rents.

"While it will scare most sponsors so they won't rent," Mr. Samson said, "there is also a group of sponsors who converted buildings with no intention of selling all the units. They simply sold the minimum and are holding the rest for the sole purpose of avoiding rent regulation and renting them out at free-market rents."

Likening those sponsors to Br'er Rabbit manipulatively pleading, "Please don't throw me in the briar patch," Mr. Samson said those sponsors, in truth, "don't want to sell."

"If they are told they can't evict," he said, "then they are protected from having to sell, and they are able to keep charging extraordinarily high and unregulated rents."
GRAPHIC: Photo: Emil Harris, left, whose tenant protection was upheld in a rented apartment in a co-op building in Brooklyn. From left were a daughter, Christine; a son, Jon Paul; a daughter, Emilyann, and his wife, Elizabeth, seated. (Dith Pran/The New York Times)
LOAD-DATE: October 16, 1998

Evidentiary Exhibit Number 129

St. Petersburg Times (Florida)

September 6, 1998, Sunday

SECTION: HERNANDO TIMES; Pg. 1

DISTRIBUTION: HERNANDO TIMES

LENGTH: 1942 words

HEADLINE: Home values hit downturn

BYLINE: ROBERT FARLEY

DATELINE: SPRING HILL

BODY:

The house on Port Court off Spring Hill Drive was going to be Irma Rivera's last. But thoughts of moving to the outskirts of Spring Hill have been on her mind for a number of years now.

The appearance of old Spring Hill is taking a downturn, she says. More and more renters are moving in and leaving properties unkempt.

The appearance of Spring Hill Drive is so shoddy, she says, it's embarrassing to have guests drive down it to get to her house. People park on their lawns. Grass is left uncut. Medians are not maintained.

In many ways, she says, old Spring Hill isn't what it used to be.

"When I came here, it was a beautiful little town," Rivera said. "People took care of their properties. They planted flowers. Now, it's ridiculous. It's terrible."

A recent private appraisal of her property confirmed her fears.

Though just two and a half years ago her property was appraised at $ 115,000, a real estate agent told her a few weeks ago the property would now likely fetch only about $ 104,000.

"That's a big drop," Rivera said. "That hurts me. I worked very hard for what I have."

Rivera is not alone.

A Times analysis of property appraiser's data from 1995 and the preliminary figures for 1998 shows property values in the original Spring Hill have taken a downturn. In the oldest sections, average land values plunged by more than 30 percent in those three years; total market value - which includes properties with homes on them - dropped by an average of nearly $ 2,000.

The Deltona Corp. only began developing Spring Hill 30 years ago, and it's difficult for some to believe that the community, which just recently started showing up on state maps, has areas that are showing signs of age.

Some say the decline in property values is simply part of a natural cycle, that as Spring Hill matures there are bound to be areas that become less valuable as new neighborhoods spring up. Real estate experts and local residents offer various theories for the decline including small homes built for retirees that no longer meet the needs of today's home buyers, the abundance of land around Spring Hill on which to build new homes fairly cheaply and an increase in the number of renters with no commitment to the community.

Still others see little cause for concern, arguing that old Spring Hill is a vibrant community where property values are bound to go up.

Not appealing to the market

Most dramatic has been the drop in land values.

For the purposes of analysis, the Times singled out the residential properties that compose Deltona's Spring Hill (see map). The county property appraiser's office - which values property based on recent sales in the area - lowered land values in Deltona's Spring Hill from an average of $ 11,707 per lot in 1995 to $ 8,484 in 1998, a 27.5 percent drop.

Meanwhile, while the average total market value of residential properties outside Deltona's Spring Hill grew from $ 32,527 in 1995 to $ 35,578 in 1998, the market values in original Spring Hill dropped slightly, from $ 39,882 in 1995 to $ 39,684. Total market value includes not only the land value, but also the value of the home.

Particularly dramatic were the land-value declines in some of the oldest sections of Spring Hill. A look at the first three units developed by the Deltona Corp. - roughly an area north and south of Spring Hill Drive between U.S. 19 and Deltona Boulevard - shows market values dropped from an average of $ 40,109 in 1995 to $ 38,186 in 1998. It's a trend some analysts say is going to get worse.

"The older homes in some of the first communities (in Spring Hill) are not as appealing to people," said county Property Appraiser Alvin Mazourek.

People want larger homes than those early Spring Hill two-bedroom ranchers with concrete-tile roofs, which were largely marketed to retirees, Mazourek said. People want the newer homes in gated communities, ones with golf courses, swimming pools or two-car garages. And with plenty of land available, that is what builders are developing all around the outskirts of Spring Hill.

"If values go down, obviously it becomes a depressed area," Mazourek said. "People start to not take care of their homes. People don't want to put a whole lot of money into their homes because they can't get the money out."

Homes in the older neighborhoods of Spring Hill have several factors working against them, said James Moore, an associate professor at the University of South Florida's School of Architecture and Community Design. First and foremost, he said, Spring Hill's problem is "way, way, way too much land."

Older areas of Spring Hill have no particular location advantage over undeveloped areas around it. And it's less expensive to build a new home than to retrofit the older, smaller ones with the modern amenities the market demands.

And while many people find pre-war, neo-traditional neighborhoods charming, 1960s-style suburban developments like some of those in Spring Hill aren't as attractive.

"It's pretty obvious what they have there is not what the market is looking for in the future," Moore said.

Spring Hill is by no means blighted, he said. Most homes are neatly kept. But owners expecting to make a significant profit from their properties will find that more and more difficult, he said.

"Not to present a picture of doom and gloom, but there should be concerns," Moore said.

Selling is no easy task

After years of watching his property steadily increase in value, George Burmester, who has been living on New Hope Road for 13 years, got a recent tax notice that the assessed value of his home dipped slightly this year.

He wasn't terribly surprised.

"The area around me has deteriorated somewhat," Burmester said. "Some of the homes aren't being kept up."

Some homes have three or four families living in them, he said. Or they have six or seven cars out front. "For sale" signs can sit out in front of properties for more than two years.

He believes his neighborhood is on its way down, and he is considering moving to an area nearby, perhaps a new development where people take better care of their properties.

The assessed value of Art McIntyre's home on Horizon Drive has inched down in each of the past four years, going from $ 74,362 in 1995 to $ 73,601 for this year.

"I'm not complaining because it means my taxes aren't going up," McIntyre said. "But if I tried to sell it, I don't think I'd get what I put into it.

"People are not as enchanted with Spring Hill as they used to be. I hear people say if Spring Hill looked like it does now, they'd never have bought here."

Part of the problem is empty stores on Spring Hill Drive, in particular the old Winn-Dixie store. And the county's neglect of the medians along Spring Hill Drive is turning the area's appearance into that of a suburban slum, he said.

It's the time to "buy low'

Where some see decline, others see opportunity.

Dan Wetherell, an appraiser in Hernando County for the past 15 years, said that while vacant land values may have taken a plunge, the same has not happened with the value of homes.

Spring Hill wasn't developed like most neighborhoods, Wetherell said. Many lots were sold to people who live far away and planned to build a home on their vacant land when they retired. Now, those empty lots sit amid older homes.

"People are afraid to build a new home across the street from homes that are 15 years old," Wetherell said. Some lots will likely sit vacant forever, he said.

But Wetherell and others in real estate say there is still money to be made on many of those properties.

"If you put the right dwelling on the right property, it's going to sell," Wetherell said.

Real estate agent Pat Fleck is taking the "buy low" tact. She sees the falling land prices as a window of opportunity. Buy now, she advises, while it's cheap.

If you can't sell, rent

As the housing prices stagnate, more and more renters are moving into established home-ownership neighborhoods. The market has left some sellers with little choice.

After renting her home on Brechner Street for several years, Jackie Boone decided last year to sell the house. She put the house up for sale at $ 79,900 at first. It sat. Then she dropped the asking price to $ 69,900. It still sat, and continues to sit.

Eventually, Boone decided to begin renting the house again to meet mortgage payments. She says she may continue renting the house rather than selling it. Like most rental properties, Boone expects renters to maintain the house and lawn.

"If people can't sell for the price they want, they often decide to rent it," said Ellie Hess, a rental agent with Spring Hill Rental.

Renters are less invested in a neighborhood. Even with good tenants, said Moore, the University of South Florida professor, the appearance of rental signs in a neighborhood is a sure sign that a neighborhood is in decline.

Hess thinks many plan to rent their homes until the Suncoast Parkway is completed, anticipating that the direct-access route to Tampa will create a demand for housing.

Moore is not convinced the Suncoast Parkway is going to be the boon people in Spring Hill think it will be. No doubt, he said, it may spark some growth in the area, but it likely will be in newer neighborhoods.
Wanted: Community's help
Though Moore thinks the downward trend in property values in the older sections of Spring Hill is part of an inevitable cycle, he also thinks there are things the county can do to stem the problem.

The county could make infrastructure improvements in the older areas a priority. Median beautification along Spring Hill Drive is a good example, he said.

County Commissioner Paul Sullivan said that while he is all for median beautification, he doesn't think residents ought to be looking to government for a panacea.

"When you have 850-square-foot homes on tiny lots, there's not much you can do about that," Sullivan said.

There haven't been many neighborhood beautification programs initiated by neighborhood groups, he added.

"Neighborhoods should be coming together and not waiting for government to be doing it," Sullivan said. "There has to be some community pride. . . . Perhaps they need to form some neighborhood associations."

Jim McLaughlin, president of the Spring Hill Civic Association, said he would like his community group to do more, but the group's treasury limits its aggressiveness in policing deed-restriction violations.

"There is always room for more action," McLaughlin said. "But our funds are getting kind of low. Before we can go out and tackle any more, we need to bring more money into the treasury."

McLaughlin hopes beautification projects such as the one planned for medians on Spring Hill Drive become contagious, encouraging property owners to invest in their property's appearance as well. But he is not convinced the drop in property values is due to deteriorating housing stock.

"It's just a buyer's market," McLaughlin said.

Rivera, too, is convinced the area could turn around.

"It's taken a downturn," she said. "But it could be stopped.

"We have to educate people that they have to be cleaner," she said. "They have to understand that taking care of their property is taking care of their equity. If you keep up your community, the values do not go down."
GRAPHIC: COLOR PHOTO, KEVIN WHITE; COLOR MAP; Jessica Junod waits for a turn as Nicky Junod and Jose Rodriguez shoot baskets in front of the Junods' home on Lodge Circle in old Spring Hill.; locates Deltona's Spring Hill
LOAD-DATE: September 8, 1998

Evidentiary Exhibit Number 130

Orlando Sentinel (Florida)
August 9, 1998 Sunday, METRO

SECTION: HOMES; Pg. J14
LENGTH: 1495 words

HEADLINE: DON'T OUTCLASS YOUR NEIGHBORHOOD

BYLINE: Robert Bruss,Tribune Media Services

BODY:

QUESTION: My husband, a custom home builder, grew up in a lovely old neighborhood of houses now selling for about $250,000. He learned about a house in that area that had a serious fire. The owner is willing to sell it "as is" for $150,000.

Although the house could be repaired for around $75,000, my husband wants to buy the damaged house, tear it down and build a house where we would live. Our house will cost, even at wholesale, at least $150,000 to build. I'm saying this will not be a good investment.

What do you think?

ANSWER: Your husband is thinking with his heart, not his head. If he buys that damaged house for $150,000, tears it down and spends $150,000 building a new one, his $300,000 investment will be well above neighborhood home values.

Buying or building the best house in the neighborhood is not smart. Apparently your husband wants to move back to the area where he grew up so badly he's willing to make an unprofitable investment to do so.

Sorry, I don't see the wisdom of such a move unless the area is appreciating in home-sale prices.

MORTGAGE BREAK IS TAXABLE

Q: In January, the holder of our $24,500 second mortgage offered us a $4,500 discount if we could pay off his loan for $20,000. We borrowed the $20,000 at our bank, secured by a new second mortgage on our home. I've been thinking about that $4,500. Is it taxable income to us?

A: Yes. You can treat that $4,500 mortgage discount in one of two ways. One is to report it as ordinary income and include it on your 1998 income tax returns.

The other is to reduce the adjusted cost basis of your property by $4,500, just as if you paid $4,500 less for your home.

TRY OUT APARTMENT LIFE BEFORE MOVING

Q: My wife and I, ages 73 and 71, raised our family in a spacious old 10-room house that we love very much. But we think we might enjoy living in a luxury apartment so we wouldn't have to worry about home repairs and could travel without thinking about the house. But we're not sure we'll like apartment living, especially without a garden.

If we rent our house for six months, will we owe tax on the rental income we receive?

A: Yes. Rental income for more than two weeks per year must be reported on Schedule E of your income tax returns. This is also the place where you can deduct applicable rental expenses.

But your plan to move to an apartment for six months before selling your home is a great idea. One of my neighbors, for instance, recently bought a condo, found he missed having a yard and sold his condo after less than six months. By trying out apartment living before selling your house, you won't lose your $500,000 home-sale tax exemption and will be sure you're not making a big mistake.

PENALTIES ON SALE ARE TAX DEDUCTIBLE

Q: When we sold a rental property, we had to pay a mortgage prepayment penalty of six months' interest. Can we deduct this on our income taxes?

A: Yes. Mortgage prepayment penalties are tax deductible as interest. Your tax adviser has full details.

BE THERE FOR HOME INSPECTION

Q: We're in the market to buy our first home and have two questions: If we buy a new house, should we hire one of those professional inspectors you often recommend; and if we buy a used house, how can we be sure the seller and the real estate agent tell us about any defects?

A: Those are superb questions. Yes, it is wise when buying a new house to hire a professional inspector to check it thoroughly. Even new houses have defects. Reputable builders will quickly correct any problems, such as doors that don't close correctly. Be sure to accompany your inspector to discuss any problems discovered.

On the second question, you can't count on the seller and the real estate agent to disclose all the defects in a used house because they might not be aware of them. I recommend that home buyers include in their purchase offers a contingency clause for a professional inspection.

To my constant amazement, most buyers do not accompany their inspectors. This is a major mistake. Buyers (and sellers) should always follow their inspectors to discuss any defects discovered. The seller usually will agree to repair or credit the buyer for the repair cost.

MAKE OFFER - THEY WON'T REFUSE

Q: My husband and I want to buy a beautiful old house being sold by an estate. It has been listed for sale about four months. Our credit is not great but we both have jobs.

The listing agent for the house said the estate will take only a cash offer. We have a 25 percent down payment, but I'm not sure we can qualify for a 75 percent mortgage.

Is there a law that prohibits an estate from carrying back a mortgage for the buyer?

A: There is no law prohibiting an estate from carrying back a mortgage. Make your purchase offer for a 25 percent down payment and a 75 percent mortgage to be carried back by the selling estate. (I presume there is no existing mortgage.)

When the heirs see your offer and realize what their share of each monthly payment will be, that's the time the estate will decide to help finance your home purchase.

SELLING ISN'T AS EASY AS IT LOOKS

Q: The home sales market seems to be doing very well. My wife and I are considering selling our home, which is worth at least $175,000, but we hate to pay a realty sales commission of about $10,500. Do you have any guidelines on how to sell a home without a realty agent?

A: Although some do-it-yourself home sellers are succeeding in today's strong home-sales market, most sellers need professional help. In today's litigious society, the old caveat emptor (buyer beware) rule has been

replaced by "seller, beware of the buyer." Realty agents can help prevent future legal disputes by anticipating problems.

Not only must sellers disclose home defects, but they need a marketing expert who understands how to find a qualified buyer, prepare a binding sales contract and then handle the 1,001 details to get the sale closed successfully.

Selling a home may look easy, but it isn't. For example, setting the correct asking price is critical to a successful sale. More important, use of the multiple listing service is the most powerful sales tool realty agents have, but do-it-yourselfers don't.

Before you decide, interview at least three successful real estate agents who sell homes in your vicinity. Each agent will give you their free comparative market analysis to show your home's market value. The listing presentations will include each agent's marketing plan for your home and their client references for you to check.

Even if you decide to try selling your home alone, the agents you interview won't mind. They know most do-it-yourselfers list their homes with professional agents within 30 to 60 days. The agents you interview will have a headstart getting your listing.

SISTERS CAN SHARE TAX BREAK

Q: I am 82 and my sister is 78. We've owned and lived together in our home since our husbands died. Now we have decided to move to a wonderful church-sponsored lifetime-care retirement home.

Our residence, which my late husband and I bought many years ago for only $36,000, is worth close to $400,000. Its sale will pay for our retirement home entrance fees. Do we get only a $250,000 tax exemption or can each of us claim a $250,000 tax exemption so our entire profit will be tax-free?

A: If both of you hold title to the home and you have each owned and lived in it any two of the past five years before its sale, then each of you qualifies for up to $250,000 tax-free principal residence sale profits. Thus, all your profits will be tax-free.

But please consult your tax adviser. I suspect your adjusted cost basis is higher than $36,000. You probably added capital improvements during ownership, thus increasing your basis.

Also, when your husband died and you inherited his share of the house, you got a new stepped-up basis on at least 50 percent of the home's value at that time. In community property states, the stepped-up basis usually applies to the home's entire value when the first spouse dies.

REMODEL OR MOVE? IT'S A PERSONAL CALL

Q: My wife and I are debating whether to remodel our home or sell it and buy a larger house that meets our need for more space. We've been looking, but can't find a house we can afford in the same top school district for our three children.

After my wife and I spend a Sunday afternoon looking at homes, we come back to our current home and agree we didn't see anything we like better. Is there any guideline on when it pays to remodel and when it pays to move up?

A: No. The decision you must make is so personal that no generalized rule is available.

Congratulations on putting school quality at the top of your home location list. Many parents buy homes in poor quality districts and wonder why their children aren't doing well in school. Because you haven't been able

to find another home meeting your family needs, it sounds like you've almost come to the decision to remodel rather than sell.

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HEADLINE: Building ownership isn't all it's cracked up to be

BYLINE: Pelletier, Steve

BODY:

Many physicians believe it's better to own than rent their medical office buildings. But ownership isn't always the best option.

Although commercial property can be a good investment, there are some widely held misconceptions about the potential benefits of building ownership. I'll begin by dispelling some of the more common myths.

"I'll Save On Rent By Owning The Building I Work In."

One of the main determinants of a building's selling price is the revenue one can expect to generate from leases. By occupying this space yourself, you lose the opportunity to collect the maximum potential revenues. The fact is, there will always be an occupancy cost associated with a medical practice.

"As Owner Of The Building, I Will Have More Freedom To Do As I Want."

Requirements such as floor space and any leasehold improvements can easily be adapted to your needs whether you rent or own your office. Physicians have a reputation as being reliable tenants and usually have no problem having their office needs met.

"I Will Benefit From Significant Tax Advantages By Owning The Building."

Investments based purely on tax benefits-are rarely worthwhile. To be a good investment, a building should come with an expectation of a good long-term return, either in the form of positive cash flow or appreciation in value.

"There Isn't Much Work Involved In Owning A Building -- It Runs Itself."

Owning and managing a building is very different from practising medicine. If you purchase a building that has tenants, you will have to manage everything from accounting to negotiating -- or pay to have it done for you. Either way, there is a cost.

In addition to these misconceptions, there are other issues to consider if

you're contemplating ownership of an office building.

Is The Building Marketable?

A building will be far more valuable if it interests a variety of tenants. If the building is only appropriate for a medical office, your market will be limited to other physicians when you decide to sell.

When Should You Sell?

Physicians don't tend to sell their medical office buildings until they retire or they have to move their practice. However, these could be the worst possible times to sell. An urgency to sell usually puts you at a disadvantage. And leaving a vacant space reduces the value of your building.

If you plan to sell your building, make plans well in advance, not at the last minute. Consider selling the building five to 10 years before you retire or plan to leave. This allows you to offer the purchaser five to 10 years of rent while you continue to occupy the space for your practice. Not only will this make the building far more marketable, it will also make your departure infinitely more easy. You won't get stuck owning your building for a prolonged period of time or, even worse, practically giving it away at a significant discount.

Are Ownership And Group Practice A Good Mix?

As an owner, it can be difficult to attract other physicians to share your practice. While an abundance of physicians may be interested in joining the practice, they may not be as interested in sharing in the ownership of the building.

When a group practice is housed in a building owned by only one or a few members of the practice, there is potential for friction. The owner or owners may find themselves in a conflict of interest when leases become due for negotiation. As members of the practice, they should be negotiating for the lowest price. As landlords, they should be negotiating for the highest price. This situation becomes even dicier if there is an opportunity to relocate the practice. Physician owners usually resist vacating their building even if it is beneficial for the practice.

It's important to remember that managing a building and running a medical practice are two very different activities. Blending the two doesn't always work. If you are interested in buying a building, it may be best to rent space for your practice elsewhere. That way, your practice and property decisions can be made independently.

Do You Have Time To Manage A Building?

As with any investment, a building must be managed well. This includes overseeing all aspects of the building's day-today operations as well as

keeping up to date on the real estate market.

Is A Building The Best Investment?

Investing in a commercial building is a risky venture if you're not an expert. Make sure that your expectations for returns take into consideration the risk you will carry and the work you will put into managing the building. At the very least, compare your expected returns with the returns you would earn with another type of investment.

Most important, make sure that you get good advice from a professional before you decide to buy.

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BEST WARNING LABEL

US West Dex "On-the-Go" Driver's Edition of the Yellow Pages

"Caution: Please use this directory only when your vehicle is parked." Now, if only the plans for a new area code were as logical...

BEST PLACE TO BUY/SELL A USED CAR

Vacant lot at 21st and Federal

Folks tired of used-car hucksters park their cars and motorcycles on this lot and advertise to all the passing traffic on Federal Boulevard. Look for lots of pickups, motorcycles and junkers, with the occasional hydraulics-hyped lowrider or a sweet foreign job. There's a pay phone on the corner for last-minute calls to a mechanic, and a rudimentary grasp of Spanish can be helpful. Even if you're not in the market for a new ride, you can spend an enjoyable afternoon watching amateurs practice the art of the deal.

BEST PLACE TO BUY A CAR THAT ISN'T REALLY A PLACE

J.V. Auto Consultants 987-1585

There are other auto consultants around, but none are more attentive and low-pressure than Phil St. Romain, president of J.V. Auto Consultants. Buying a car through St. Romain's company couldn't be more different from a visit to a car lot. Call him up and tell him which cars you're interested in. For a percentage of the sale cost--usually a few hundred bucks--he'll quickly arrange test drives through the dealership's fleet managers, who, since they won't be selling to you, won't try to edge you into a scary back room to hear their "absolute best deal." Then he'll shop around--out of state, if necessary--to find the cheapest price on your selection. He'll even deliver your new car to you. You'll never have to cross paths with a hovering, jewelry-wearing, cologne-enveloped salesman again.

BEST GEARSHIFT ART

Galeria Mexicana

3600 W. 32nd Ave., Ste. B

Why drive around with some factory-installed, secular blob of vinyl topping your gearshift when you could be downshifting with the thorn-crusted face of Jesus or slamming the Guadalupe virgin into overdrive? While you're visiting this brilliant and colorful collection of Mexican Christiania at Galeria Mexicana, pick up a dashboard shrine kit--or some 1950s Mexican movie posters and Aztec refrigerator magnets. Call ahead to see what's in store.

BEST CAR MUSEUM

Gallery of Cars

1144 Broadway

Cherry Harley-Davidsons and vintage Porsches chummily rub bumpers in the cramped Gallery of Cars garage, but each one is beautiful beyond compare, refurbished and rarin' to go, and most are for sale. That includes collector's-edition scale-model cars and motorcycles that ape the big ones but don't cost nearly as much and look great on a bookshelf. If you just like to look, the grand tour can be completed in one sweeping peek through the storefront windows facing Broadway. Tempting, isn't it?

BEST BUS ROUTE

SKIP in Boulder

The very convenient SKIP bus route in Boulder is one of RTD's biggest success stories. The brightly painted SKIP buses are smaller than standard RTD buses and carry bike racks, and during peak times, they run every six minutes up and down Broadway, the city's main drag. Boulder riders, including thousands of University of Colorado students, have flocked to the handy new bus line; since introducing SKIP, use of the Broadway route has jumped 150 percent.

BEST FREE SERVICE

Denver Public Library 24-hour telephone renewal service 691-0458

Is it one of the best things in life? Probably not, but it is free, and it could keep you from nickel-and-diming yourself out of favor with the Denver Public Library. Last fall the library introduced a 24-hour automated renewal line that helps remove one tiny burden from your already overloaded schedule; now you can renew a book when the mood strikes, even if it's midnight on a Sunday. It's one of those little things, but it's a good one.

Readers' choice: 16th Street Mall shuttle

BEST ALMOST-FREE LABOR

City of Englewood Rent-a-Worker Program

762-2660

Here's a best-of-both-worlds situation: You can't lift a snow shovel, and there's a kid on the next block who could use some pocket money. The Rent-a-Worker program, run under the auspices of the Englewood Department of Parks and Recreation, matches people who have jobs that need doing with students in grades five through twelve who are ready and willing to work. It's a simple solution that brings people together and benefits everyone involved.

BEST FREE ADVICE

Ellen Speare, Wild Oats Market

440-5220, ext. 373

Got a headache? Feeling depressed? Ellen Speare may be good for what ails you. The clinical nutritionist is available for free consultations by appointment at the Washington Park and Denver West Wild Oats stores. In keeping with the Wild Oats spirit, Speare specializes in holistic health alternatives; she'll happily guide you to the right combination of herbs, extracts and healthful practices with which to battle your everyday maladies.

BEST TELL-A-MEDICINE

Health and Medicine Resources

www.aclin.org

Taken as a whole, the Access Colorado Library and Information Network performs the same kind of service as those bespectacled librarians hidden among the stacks: It channels all kinds of free information your way. At the click of a mouse, for instance, ACLIN can get you a list of the best books for kids of any age group. But the network's Health and Medicine Resources Web site is a true gem. Developed with input from, among others, the CU Health Sciences Center's Denison Library, the site provides consumer information about drugs, health plans and clinics, access to support groups, mental-health resources, links for alternative therapies, patients' rights, fitness issues and just about anything else you might want to know. Next time the old body breaks down, ACLIN could be the place to find out how and where to fix it.

BEST CHEAP SMILES

CCD Dental Hygiene Clinic

960 Xanthia St.

Nobody likes to go to the dentist, but we're not sure whether it's because of the pain involved or because of the equally discomforting misery of the bill. If you're willing to be a guinea pig for student dental hygienists, you can get your teeth cleaned, examined, X-rayed, sealed, polished or bleached at the CCD Dental Hygiene Clinic for prices considerably lower than those encountered at a typical dentist's office. You'll still have to go elsewhere for the big jobs such as extractions, bridgework and fillings, but the CCD clinic offers the cheapest preliminary work around.

BEST HEALTH-CARE IDEA

The HMNo

3535 S. Lafayette St., Ste. 203, Englewood

Drs. Jonathan Sheldon and Heather Sowell, a husband-and-wife team of physicians, got fed up with insurance companies telling them how to treat their patients. So in March they opened their HMNo to sidestep the usual hassles involved in dealing with health insurance. Instead of worrying about their bottom line, Sheldon and Sowell emphasize old-fashioned, quality care. Patients pay their own bills, but the benefits are numerous, Sheldon says. The average waiting-room time is three minutes, the doctors make house calls, and they'll spend as much time with patients as the patients want or need. "If you call me at 3 a.m. and say, 'I'm sick,' I answer the phone," Sheldon says. "It's at my bedside."

BEST POTIONS

Apothecary Tinctura

3425 E. 12th Ave.

Gone are the days when pale, consumptive ladies languished in Victorian gardens drinking herb tea and popping Granny's natural curatives. Supermoms and professionals just don't have time for that sort of thing. But that doesn't mean that natural extracts, teas and herbs can't still be part of your stressful modern life. Apothecary Tinctura stocks them all and, to help get you started, provides the expert insight of New Mexico-trained clinical herbalist/owner Shelley Torgove, who gives private consultations and teaches classes on everything from making your own herbal cosmetics to the basics of Green Pharmacy 101. In the end, though, it's the apothecary's

little extras--sweet-smelling lavender-rose eye pillows, restorative bath salts, live herb plants to grow at home--that make every visit so pleasant.

BEST BARGAIN MASSAGE

Colorado School of Healing Arts Clinic

7655 W. Mississippi Ave., Lakewood

At the Colorado School of Healing Arts Clinic, students are on their way to becoming full-fledged massage therapists. You can help them along and help yourself at the same time. For $20 per hour-long session, a ready-to-graduate masseuse will apply Swedish massage techniques to your aching body, working out the kinks and releasing those toxins dumped into your muscles by unrealistic deadlines and your teenage son, who just told you he got a body part pierced but can't tell you where. At more than half the price of most massages, maybe you should spring for two hours.

BEST MENTAL-HEALTH SERVICE

Weekend Ventures

Aurora Central Library

14949 E. Alameda Dr., Aurora

367-KIDS

Perhaps the highest price parents pay these days is the sitter's fee. What once was a small cottage industry whereby the neighbor's kid could earn a little dough has become big business; in some cases, you might need to go through a switchboard in order to schedule a costly child-care appointment so you can go to the movies three weeks from now. Weekend Ventures wants to put some sanity back into the situation. From 5 to 11 on a Friday or Saturday night, and for a nominal hourly rate ($3 for the first child and $2 for additional ones), the group will watch over your little darlings (ages three to twelve), provide special activities to keep the kids busy, and they'll do so in the intellectually stimulating environment of a public library. Call ahead to register, or just drop in.

BEST WOMB WITH A VIEW

"Family Birth Place"

Presbyterian/St. Luke's Hosptial

Clip this paragraph next time you're in labor and demand to be taken immediately to the sprawling room known among the staff here as the "family birth palace." Featuring a majestic view of the Denver skyline outlined by a postcard Rocky Mountain backdrop, a dining table and chairs for entertaining postpartum guests, a galley kitchen for whipping up hors d'oeuvres and chilling champagne, and a blessedly comfortable double bed, this room belongs at the Brown Palace. But who's complaining?

BEST TRAINING FOR FATHERS-TO-BE

Boot Camp for New Dads

St. Joseph Hosptial

St. Joseph Hospital's "Boot Camp for New Dads" is a three-hour workshop for expectant fathers, who usually take the course about a month before their babies are due. Veteran dads who have already been through the camp give baby-care lessons to the rookies, even passing around their own bundles of joy so the

fathers-in-training can get some hands-on experience. After all, as facilitator Chuck Ault points out, many of them have never held a baby before. The dads-to-be also discuss such topics as balancing work with family and how to be supportive of new moms. After all, parenting is a family affair.

BEST PLACE FOR GRANDPARENTS EXPECTING OUT-OF-TOWN VISITORS

Baby Junction

12300 E. Cornell Ave., Aurora

Your first grandchild is about to arrive for a three-day visit, and you don't want to shell out $200 for a crib. Fortunately, Baby Junction has a solution. For about twelve bucks for three days (the daily cost goes down the longer you need it), the store will rent you a mint-condition crib. The Junction also rents out car seats, high chairs and strollers. In fact, they have just about everything you'll need for those three days--except sleeping pills.

BEST ADVICE ON WHERE TO THROW AWAY YOUR TRASH

RecycleNet recycling bulletin board

governor.state.co.us/gov_dir/oec/recyclenet/

These days you don't just throw stuff away. In this age of recycling, there's a place for everything; the problem is, you don't always know where that place is. You do know, however, that it's not at the back of your garage collecting dust and providing a warm home for mice. If it won't sell at a garage sale, log on to RecycleNet, a statewide site that links you up with the right resting places for your recyclables.

BEST EDUCATIONAL WEB SITE

Denver Museum of Natural History

www.dmnh.org

What do you do on a rainy day? How about a trip to the Denver Museum of Natural History? If that's not possible, the next best thing is a virtual visit, courtesy of the new DMNH Web site, which is something like a mini-sojourn through the museum's dioramas (albeit without the dino-boned, echoing-hallways ambience). The site's coolest feature is the DMNH Adventure Cam, which offers 360-degree views of your favorite exhibits.

BEST POST OFFICE

Glendale Post Office

945 S. Birch St., Glendale

The Terminal Annex is out; the frazzled customers and staff seem a little too close to going postal there. If you want the primo place for sending mail, try the Glendale Post Office. Just a few blocks east of Colorado Boulevard, the office is clean, spacious and state-of-the-art. Service is friendly and efficient, but there are also plenty of stamp machines and convenient do-it-yourself stations for those in a hurry. Last, but certainly not least, parking is plentiful.

BEST WAY TO MAKE BOOK

Library self-checkout equipment

We always knew the day would come when bar-coding would suddenly seem like a friendly invention, and that time is now. At certain Denver, Jeffco and Boulder public libraries, you can opt to check out your own

books instead of waiting in line to have someone do it for you. All you do is slip the book in, let the machine read your code and wait for it to spit out a slip cataloguing what you've checked out and reminding you of when the book is due. And, as if to prove how easy it is, there's even a separate self-checkout unit in the children's quadrant of the Boulder library--you just have to be tall enough to see what you're doing. The machines can be used to check out books only (for other media, you still have to go through a person), but this could be the start of a beautiful non-relationship.

BEST BOOKSTORE FOR BIBLIOPHILES

Abracadabra

32 S. Broadway

Relocated from northwest Denver, Abracadabra is the most high-class of the bookstores clustered on South Broadway. That means it's also the most expensive. But if you're a collector--a real collector who's into first editions and rarities--this has to be your first stop.

BEST SPECIALTY BOOKSTORE

The Gallagher Collection at the Antique Guild

The Gallagher Collection at the Antique Guild offers top-quality material, tastefully arranged and boasting sections of Western history and Coloradiana; one glass bookcase is filled with nothing but African-American history and novels. This is far from the biggest cache of books in town, but Don and Sue Gallagher treat their volumes with loving care and cater to the specialist's needs.

BEST HISTORY SECTION IN A USED BOOKSTORE

Ichabod's

2 S. Broadway

This dusty staple on Broadway's book-lovers' row offers everything from old copies of Ostrogorsky's classic History of the Byzantine State to well-preserved coffee-table tomes on Mesopotamian ruins and the British monarchy. For those with an interest in the history of civilization and a fondness for the feel of a solid book in their hand, Ichabod's provides a much-needed respite from the glare of the computer screen.

BEST COLLECTION OF WAR BOOKS

Imaginary Wars collection

Colorado State University

1-970-491-1844

The Imaginary Wars collection got its start in the mid-1960s when a former CSU librarian came across a book about Denver becoming the capital of the United States as the result of a war. Since then, it has grown to include about 1,500 titles, among them "The Texas-Israeli War: 1999" and "Civil War II: The Day It Finally Happened." But this isn't science fiction, cautions librarian John Newman: The collection focuses specifically (and exclusively) on novels that depict future wars or imaginary past wars among known societies on Earth. As Newman notes, "We don't deal with books about the vapor people fighting the worm people on unicorns." To arrange a look through the collection, call Newman for an appointment.

BEST COLLECTION OF ROMANCE BOOKS

Beth Anne's

2204 Pikes Peak Ave., Colorado Springs

If you're due for a dose of heaving bosoms and flowing Fabio hair, Beth Anne's bookstore is the place for you. Beth Anne's specializes in romance novels, which make up about 60 percent of the new books the store orders. Owner Beth Anne Steckiel will put you on the path to bliss between the covers (of a book, that is), recommending a juicy read and making sure you tackle the romance series in the right order. Beth Anne's also hosts book signings by local and nationally known romance authors, and during the winter months, the shop's blazing fireplace is just the thing to get that hot blood coursing through your veins.

BEST BOOKSTORE CRANNIES

West Side Books and Curios

3616 W. 32nd Ave.

Here's what some of us think a used bookstore should be--like someone's musty attic of memories combined with a quaint house of curiosities. Lois and Jim Harvey's West Side Books is both. While its main focus is on tomes, especially the unusual and out-of-print (appraisals and searches are among the services offered), it's also piled high with stuff--old pottery and reading lamps, china curios and prints, used CDs and handsome chairs. We're particularly partial to West Side's eclectic collection of bookends, including serious brass owls, china Bambi deer and a pair of fake gilt Thinkers who perpetually ponder the meaning of life.

BEST BOUDLER USED BOOKSTORE

Red Letter Secondhand Books

1737 Pearl St., Boulder

You'd figure that a college town would have several high-quality used bookstores, and Boulder does. But Red Letter wins by a nose when it comes to offering an efficient store with reasonably priced arcane material. The store gets an A for expertly arranging its tomes for good browsing, too, and its knowledgeable staff is a plus.

BEST LODO USED BOOKSTORE

Book Roundup

1756 Blake St.

Okay, so maybe it's the only used bookstore in LoDo, but thank heavens for that. Book Roundup, which relocated from Aurora to Blake Street in April, is not the biggest used bookstore around, but it has an admirable collection, especially in fiction, biography, history and art, and the prices are low, low, low. A desperately needed alternative to the sports-bar scene.

BEST STAR WARS MEMORABILIA

Space Station

2441 S. Broadway

The Space Station is one of those odd shops where the strangest little things can transport you to, well, wherever you want to go: outer space or a place far, far away--even back to where your inner child resides, hungry for the nourishment of a good old-fashioned space Western. In the tangle of used toys that is the Station,

you can find Luke, Han Solo and Chewbacca models in every size made from any Star Wars period. But the coolest thing about the place is that on this stretch of South Broadway, the clientele that wanders in will often remind you of a certain Star Wars bar scene.

BEST XENA COLLECTION

The Book Garden

2625 E. 12th Ave.

If the ululating war cry of Xena, Warrior Princess, makes your heart skip a beat, head directly to the Book Garden. This women's bookstore carries an extensive collection of paraphernalia--including books, videos, posters, T-shirts, pewter figurines, wine goblets, mugs and clocks--that pay homage to late-night TV's commanding swordswoman. One especially hot seller is a photo of Xena hot-tubbing with sidekick Gabriella. "It's like a Xena-rama here," says Debra Myers, book buyer for the store. The truly diehard fan can purchase an official fan club kit, complete with a fan club wallet card. And stay tuned: The Garden may soon be hosting a Xena look-alike contest or war-cry competition.

BEST ARMY GUYS

Musket Miniatures

439-9336

Jim McCarron and his son, Jeff, the team behind Musket Miniatures, command the legions of pewter military figurines marching from their Broomfield workshop. Civil War figures are their primary focus, but they also craft tiny soldiers from the American Revolution, the Mexican War and World War II, as well as civilian figures for use in model railroading. All figures are handmade from original designs, and the McCarrons do most of their business from catalogue orders.

BEST PLACE TO BUY YOUR FIRST WORK OF ART

Zip 37

3644 Navajo St.

You can't go too far wrong in any of the galleries in the mini-bohemia of northwest Denver that Pirate built, but we're partial to Zip 37 for three reasons: local artists, good prices and a consumer-friendly atmosphere. It also helps that the artists themselves are often on hand or easily accessible to explain their work to the perplexed.

BEST HOLIDAY SHOPPING

Kaleidoscope

True shopaholics with taste know that some of the best stuff in the universe can be found in museum shops, where selective buyers have an eye for well-made handcrafts, educational items, painstaking art reproductions and other merchandise from the elegant to the whimsical. But going museum-shopping usually means you have to go to the museum, and, well, that time-consuming activity could cramp a shopaholic's style, especially during the holidays. So Kaleidoscope --a benefit for the 4 Parents Helpline, which offers information and referrals for troubled families--brings together merchandise from dozens of cultural and civic organizations in one place. Whether it's the latest in cat toys from the Cat Care Society or a beautiful box of notecards from the Denver Art Museum, you're sure to find something for someone at the annual October event, taking place this year at the Greek Community Center.

BEST HALLOWEEN COSTUMES

Red Rocks Community College Theater Department

914-6458

What's the scariest thing about Halloween? How about trying to find a brilliant costume at the last minute? Here's a solution that's good for all concerned: The Red Rocks Community College theater arts program beefs up its coffers by renting out items from its extensive costume collection, said to include nearly 1,000 masks, hats, capes, feathery things and other character props and disguises. Furthermore, they'll go as far as your imagination takes you--from garden-variety witches to trendy goddesses to a one-of-a-kind getup designed just for you. There's no trick to it: Rentals start at a mere $5 and are available year-round.

BEST VALENTINE'S DAY CARDS

Boulder Ars & Crafts Cooperative

1421 Pearl St., Boulder

Why settle for the pseudo-folkie cards from Hallmark when you can get a genuine, one-of-a-kind handmade original signed by the artist? Every January, the Boulder Arts & Crafts Cooperative gets a unique selection of Valentine's Day cards made by local schoolkids--plenty of glitter and sequins, paper hearts, cotton balls and original poetry scrawled in crayon. They're cute, affordable (around $2 per card), and the proceeds benefit local charities. What better way to impress your sweetheart?

BEST EMBARRASSING VALENTINES

Barbershop Quartet Singing Valentines

973-9217

In the world of the barbershoppers, you can never rhyme "moon" and "June" too many times--it's a combination that always works, no matter how much you corn it up. The next time you want to give your sweets an impassioned gift that swings, give the Barbershop Quartet Singing Valentines a call: On Valentine's Day, they deliver the mush in four-part harmony anywhere you direct, provided you can line them up before their schedule's full. Guaranteed to make the most curmudgeonly recipient blush like a sweetheart rose.

BEST LINGERIE

Le Soutien

3000 E. 3rd Ave.

There are those of you--and you know who you are--who believe that lingerie wasn't meant to take flirtatious wing on brazen television commercials that leave nothing to the imagination. If you're looking for a dark, cool, private place draped in silk, cotton eyelet and delicate lace, Le Soutien has the ambience you crave, where helpful salespeople ensure the correct fit, and everything is still a beautiful secret.

BEST SUPPORT SERVICES

Treva's Bras

Villa Italia Shopping Center

Remember how you used to sneak peeks at the natives' naked breasts in National Geographic when you were a kid? Remember how they hung down like cow udders? Well, that's what yours are going to look like by

the time you're sixty if you don't wear a good bra. The best can be found at Treva's, which for 26 years has been making Denver more beautiful with "custom fitting," whereby professional bra fitters measure you all over and find the perfect fit. And if you're like just about every woman in the world, one's smaller than the other and makes one side of the bra wrinkle. Treva's can fix that with something they call "extenders," little pads that flesh out your look. And every bra they sell is guaranteed not to look like an old jump rope after a few washings. So do yourself and those around you a favor: Burn your bad bras and head to Treva's.

BEST SUPPORTIVE SERVICE

Tailored Transitions

3003 Arapahoe St.

The nonprofit Tailored Transitions provides donated professional and business clothing to low-income women who are making a move into the working world. But it's about more than just suits and shoes: Having the right look helps build confidence and self-esteem. Women are referred to the organization by job-placement agencies throughout the state; once there, they are set up with as many as five outfits free of charge. Tailored Transitions has helped more than 700 women since it started taking clients in late 1997--and that's good for business.

BEST PLACE TO GET A PROM DRESS

The Prom Dress Exchange

232-3861

Here's a thrifty alternative for high-school girls (and their parents) who don't want to cough up hundreds of dollars to buy a formal dress. The Prom Dress Exchange lets girls bring in a dress that's been worn once, select another from about 150 dresses that others have exchanged or donated and make a trade--with no money involved. The Exchange is run by Serving Kids, a coalition of Jefferson County nonprofits that provides clothing for low-income children; the program really shows style by offering dresses to girls who can't afford to make a trade.

BEST BRIDAL RENTALS

Karen's Discount Bridal Outlet

4101 E. Louisiana Ave.

Even if it's Friday morning and you're eloping to Vegas on Saturday night, you can still walk down the aisle in style. Karen's Discount Bridal Outlet has about 400 wedding gowns for rent at prices ranging from $75 to $450, including cleaning and alterations. Same-day rentals are possible if no alterations are required, but if Karen's in-house seamstress has to make some nips and tucks, she needs a little more time. If you have more than a few hours to plan your wedding but simply don't want to buy a lot of one-wear clothing, Karen's also rents children's dresses, gowns for the mother of the bride and sets of bridesmaid dresses. Groom not included.

BEST PLACE TO OUTFIT YOUR LITTLE PRINCESS

Jordan Marie

Cherry Creek Shopping Center

Nothing's too precious for your little darling, and Jordan Marie knows it. Not only does this high-end kids' clothing store sell princess outfits (complete with tiaras), but it also offers monogramming, booties and "the cutest matched sets I've ever seen," according to one Cherry Creek mom.

BEST PRICEY KIDS' CLOTHES

B. Bear Express

3000 E. 3rd Ave.

Aside from being a never-ending job, buying clothes for kids can be a pain in the butt. Part of you wants to dress them up in adorable doll clothes, while the other part imagines what they'd do to the precious outfit--and in how little time. B. Bear Express takes all of that into consideration, selling clearly adorable frocks that are frilly without being repulsive and cute linen overall shorts for boys guaranteed to look good at least long enough for one grandma snapshot. It's not cheap, but it's oh-so-cute, and since B. Bear has a companion shoe shop right next door, you can literally outfit the kid from head to toe.

BEST ONE-OF-A-KIND KIDS' CLOTHES

Porcupine Kids' Clothing

1619 Williams St.

In our book, whimsy is a tangerine swing jacket over a saucy bug-print full skirt trimmed with an eye-catching, yellow-and-orange-checked ruffle, or boldly striped bike shorts topped by a polka-dot sleeveless dress. Add crayon-colored kangaroos and grasshoppers or strutting roosters that smile beguilingly from hand-painted tees and rompers, and you've got the essence of Porcupine Kids' Clothing, which turns out the cutest darned all-cotton tykes' togs you've ever seen. And here's a blanket statement: Porcupine entrepreneur/ artist Wendy Morrison says she's now branching out into equally fanciful kids' bedding.

BEST USED KIDS' CLOTHING

Children's Exchange

560 S. Holly St.

Hand-me-downs are a way of life when you're a kid, but if you're not fortunate enough (or unfortunate enough, depending on your point of view) to have an older sibling, cousin or buddy to supply you with used clothes, you can happily settle for merchandise from the Children's Exchange. A walk through this consignment store quickly uncovers racks of sturdy, hardly used name-brand clothes, including ribboned to-die-for frocks and indestructible Gap denim overalls, as well as recycled strollers, cribs and car seats at prices far more reasonable than they were the first time around.

BEST AFFORDABLE CONSIGNMENT STORE

Mercer Place

2371 E. Evans Ave.

Too squeamish for ARC? Too tapped for the Snob Shop? Mercer Place offers a good selection of previously owned basics from the Gap, Eddie Bauer, Liz Claiborne and other popular lines at reasonable prices. The store also features a men's section and a respectable selection of shoes and accessories. Older items are marked down monthly and the stock turns over quickly, so visit often.

BEST VINTAGE STORE FOR A LIMITED BUDGET

The Bunker

The Tivoli

Anyone who has checked out the merchandise carried by premier vintage dealers knows that buying vintage clothing can become an expensive pastime. The Bunker, with a perfect location to cater to the low- and no-income college crowd, offers nice vintagewear at a fraction of the usual costs. Where else in town can you find a gabardine jacket for under $35 or a chenille robe for less than $30? And while the Bunker is mainly a source for both vintage and recycled clothing, it also carries a small selection of well-priced vintage jewelry.

BEST VINTAGE/CONTEMPORARY STORE FOR AN UNLIMITED BUDGET

Babareeba Clothing Exchange

3215 Lowell Blvd.

When Jerrilyn Berardi was a little girl, her mother dragged her around to swap meets, garage sales and thrift stores in search of great fashion finds. What seemed boring at the time became the basis of a lifelong passion for unique vintage items and designer labels. Berardi's superb fashion sense is reflected in Babareeba's eclectic mix of men's and women's vintage and contemporary clothing: You'll find suits, dresses and cashmere jackets from past eras alongside Gap chinos and assorted items sporting such well-known labels as Armani and Donna Karan. Whether you're buying, selling or trading, you won't be disappointed.

BEST OUTLET FOR LOCAL DESIGNER FASHIONS

Squid Clothing Company

1232 E. Colfax Ave.

This glamorous sci-fi fantasy of an independent clothing store is the epicenter of cool urban ensembles for young space boys and girls, with hipster couture fashioned on the spot by local designers and the in-house label. Whether you are in need of alterations for a party or a whole new look for the millennium, Squid Clothing Company has got you covered in tops, frocks and pantaloons.

BEST HOLE-IN-THE-WALL BOUTIQUE

Attitudes

1711 E. Evans Ave.

Small, unassuming and located on a stretch of road not particularly known for being chic, this is your place--a dark den of a shop where you go for rejuvenation and girl talk and something pretty that you probably can't afford just now, but so what? Attitudes offers superior customer service, the kind lavished on you and you alone, along with a shopping wallow as rich as a chocolate bath. Standouts here include fitted silk suits in otherworldly hues, sparkly patchwork evening bags and stunning tapestry jackets cinched with striking silver buttons; stock items range from no-wrinkle stretch-velvet leggings to the perfect hand-knit, bone-buttoned wool cardigan. You might leave the store a little bit poorer than when you came in, but your wardrobe will be enriched beyond your wildest dreams.

BEST CAVERN-IN-THE-WALL BOUTIQUE

Iris Fields

1099 S. Gaylord

Imagine a place you can walk to. Or, if not, a place you can drive to on a leisurely shopping afternoon that includes lunch and window-gazing far from the hustle and bustle of Cherry Creek or Park Meadows. Iris Fields is a lot like its name--expansive, colorful, elegant and showy--yet each item inside has its own distinct charisma. The selection of boutique-wear there might range from mix-and-match separates in bright, chic rayons to businesslike patterned pieces you can dress down with a T-shirt or up with a smart jacket; you'll also find everything you need for happy accessorizing. So leave the traffic and megastores behind and have yourself a Fields day.

EST PLACE TO THE TIME OF YOUR LIFE

The Little Watch Company

The Shops at Tabor Center

A good selection of anything can sometimes be too time-consuming. And if you're consumed by time but don't have much of it to spare, the Little Watch Company is the place for a lunch-hour quickie. Go la cart: The short, sweet selection here doesn't have a single dud, further simplifying the chore of buying a new watch. Our favorites are the smart unisex Swiss Army models, available with big or small faces with a variety of bands and precision features, but there's more to choose from--just not too much more--within a reasonable price range.

BEST PLACE TO BUY PRISONERS" HANDIWORK

Colorado Territorial Prison Museum

Canon City

You've got to admire people who have time on their hands--lots of time on their hands--and know how to put it to good use. The gift shop at the Colorado Territorial Prison Museum, located in the old women's prison built in 1935, is stocked with leatherwork, purses, belts, billfolds, jewelry, woodwork, belt buckles--you name it--all created by residents of the Department of Corrections. But this program isn't open to anyone: To qualify, an inmate must have been incarcerated a minimum of ninety days, be on good behavior, carry a job within the prison and apply and be accepted to the prison's "hobby shop." And even then, he must come up with his own supplies--which could account for those cunning name bands made from the threads of unraveled socks. The prisoners set their own prices; the shop adds a 30 percent consignment fee. Even so, there are some real deals: mock arrowhead earrings, for example, made by an artisan who knows his weapons. And then there are the real masterpieces: three-dimensional windmills, wishing wells, wagons and airplanes, which one inmate makes entirely out of pictures from National Geographic. There's no hard cell here.

BEST TELESCOPES

S&S Optika Ltd.

5174 S. Broadway

Got stars in your eyes? You need expertise when it comes to finding the right gazing equipment--whether it's for planet-hunting or a better view of that loft across the way. Besides having an impressive and way-beyond-perfunctory selection of scopes and other optical instruments, the folks at S&S Optika Ltd. are happy to explain, demonstrate and give advice so you can leave the store with 20/20 vision.

BEST LOCALLY PRODUCED TOYS

Zometool, Inc.

1526 S. Pearl St.

www.zometool.com

It's a tool. No, it's a toy. What is a Zome, anyway? Actually, the Zome System, a geometric modeling method based on the same shapes Buckminster Fuller popularized with his geodesic domes in the '60s, is both a tool and a toy. A sophisticated relative of the Lego concept, the Denver-based Zome System allows tinkerers to create floating space-age shapes using little more than a clever, multifaceted connector ball and color-coded struts that jut out in search of more connectors. Zome has popped up on PBS science programs and found its way into schools across the country--from Jeffco to MIT--and around the world. The important thing, though, is that Zome is fun to play with. Just ask any kid.

BEST TOY GUN COLLECTION

Maggie May's Sandbox

212 S. Broadway

Reach for the sky, toddlers! You really shouldn't go into Maggie May's Sandbox without your oater-trivia six-shooters on, though even a passing grasp of who wore the white hats and who wore the black hats on '50s television Westerns will suffice if you want to go face-to-face with the owner of the place. He knows the origin of every cap gun and reproduction on the wall, as well as who pulled every original's trigger. And there are plenty of them here. Hi-ho, Silver...and away!

BEST PLACE TO BUY BEANIE BABIES

Caravan & Company

8116 W. Bowles Ave., Littleton

It's no secret why children love Beanie Babies, the stuffed animals manufactured by the Ty company--they're cute, cuddly and the perfect size for young hands. More mystifying is the large number of adults who are willing to pay exorbitant prices for fistfuls of fabric with names like Inky and Chomp. And plenty of them are: Beanie Babies have become one of the hottest collectibles on the market. Caravan & Company is a godsend for both age groups. The store stocks a huge supply of the little critters at reasonable prices and occasionally allows customers to special-order upcoming batches so they won't miss out on the latest and, uh, greatest.

BEST PUPPETS

The Puppet Store

Denver Puppet Theatre

3156 W. 38th Ave.

What's on hand? At the Puppet Store, the answer is obvious. An adjunct of career puppeteer Annie Zook's northside Denver Puppet Theatre, the shop has a bounty of puppet-related merchandise, from miniature finger models to complicated marionettes. Nothing sparks little imaginations better than a puppet show, and here's the place to get your own home theater started.

BEST GEWGAWS

Al's Collectibles and Antiques

Upstairs in the Broadway Broker

1438 S. Broadway

Al Garcia had better hope he never has to move from his South Broadway location. He has a mountain of books, magazines, cigarette lighters and high-quality tchotchkes crammed into a spacious second-floor space on Antique Row. Yet everything looks fanatically neat. Garcia calls his place the Store of Three Wonders: "You wonder if I have it. I wonder where it's at. Everybody wonders how I find it." If you're going to lose yourself in an antique store, Al's Collectibles and Antiques is the place to do it.

BEST FOLK CURIOS

Garnet Gecko

3631 W. 32nd Ave.

Some devoted shoppers are bargain-hunters who get their kicks from the thrill of the hunt. Others are methodical scientists, and still others like nothing more than to spend, spend, spend. But no shoppers have more fun than the ones who seek out things they've never seen before and may never see again. Shops like the Garnet Gecko are for them. It's stuffed with notions from Oaxaca and Indonesia, including colorful wooden animal puzzles, carved lava-stone objects, fantastic hand-painted cacti, tiny footstools in the shape of pansy blossoms, silver and gemstone barrettes and intricate batik textiles--all of which make Garnet Gecko quite a gem.

BEST FLEA MARKET IN A HOUSE

Paria Flea Market

1439 S. Pearl St.

The Paris Flea Market is actually a house filled with vintage home and garden items culled from estate sales. Buyers can roam through the house, searching for treasures that could include bird cages and 1940s Swingline staplers. The Flea Market also carries one-of-a-kind jewelry crafted by Jane Asper, who owns the store with her daughter, Vanessa Lyon.

BEST ANTIQUE TEA SETS

Willow Antiques and Gifts

3030 E. 2nd Ave.

You'll have to go underground to find Willow Antiques and Gifts, a cheery little garden-level bunny den of a store filled with ceramic frames, cowboy lamps, mint-condition Hopalong Cassidy cups and adorable, fuzzy appliqued pillows. Once you're there, be sure to investigate the sparkling tea sets, which include delicate, gold-edged china florals, bisque sets and pink lusterware perfect for a ladies-only tea party. Don't forget your white gloves--and keep that pinkie up.

BEST PERSONALIZED PLATES

Willa Jolly

Sponsler Specialized Services

526-9507

www.sponslergifts.com

Wilma Jolly, an Arvada homemaker, hand-paints commemorative dinner plates for Sponsler Specialized Services, a Golden-based business. Since 1963, Jolly has turned out nearly 27,000 plates bearing illustrations

and information marking events such as weddings, births and anniversaries. Jolly and another painter create the plates in their homes; company owner Elaine Sponsler then sends them to customers from a shipping operation she set up in her greenhouse.

BEST JEWELRY ARTIST

Suzanne Williams

Imagine having the city at your fingertips. No, we're not talking about the phone book or the Internet. We're talking about the instant access that's possible when you're wearing one of Suzanne Williams's capriciously detailed pendants and pins, each of which houses that familiar Denver skyline, cash-register building and all, in a sterling-silver diorama less than a square inch in size. Available at the Pismo gallery at 235 Fillmore Street in Cherry Creek, they're finished with sparkling marcasite stars and that sense of dazzling wonderment a city can inspire. It's like wearing a keepsake locket with a picture of your favorite place wherever you go--only more distinct.

BEST BEAD SHOP

Skyloom Fibres

1705 S. Pearl St.

When it comes to beads, quantity is quality--you can never have enough of them, and, more important, once you're hooked, you can never stop looking for more. Skyloom, primarily a fiber store filled with yarn, has always had beads on the side, but its stock has grown exponentially over the years to include glass, bone, metal, ethnic--you name it, they've probably had it at one time or another. These days the emphasis is on plastic--contemporary, vintage, and retro beads from the '40s, '50s and '60s--but Skyloom also offers some of the best-priced glass beads in town, along with metal stampings, antique buttons, strands from Africa and a bead-weaver's favorite, tiny opalescent Delica seed beads from Japan.

BEST HEAD SHOP

Pipe Dreams

1538 Wazee St.

Pipe Dreams is a beautifully restored storefront with heavy wooden beams, exposed brick--and none of the riffraff who usually hang out in such places. Catering mostly to the LoDo cigars-and-martinis crowd, Pipe Dreams carries everything from local art, stickers and incense to pipes, rolling papers and the lowest-priced Graphix water-filtration kits in the metro area. But, remember, these are to be used for tobacco only.

BEST HAT SHOP

Minerva's Hat and Fashion Boutique

2737 Welton St.

Hats are the ultimate accessory, says Minerva Smith, owner of Minerva's Hat and Fashion Boutique, and she has the ultimate hat collection to prove it. Minerva's always has at least 140 hats in stock, including African kufis, boleros, bridal headwear, turbans, berets, even Chinese sun hats. Smith can create custom toppers by adding an accent to match a dress, and the boutique also carries skullcaps with matching scarves. Prices range from $29 for Smith's "budget line" to $300 for an ornate high-crowned number swathed in rhinestones, sequins and beads.

BEST SHADE SHOP

Lili Marlene Custom Lampshades

1712 E. 6th Ave.

Lampshades somehow end up the butt of countless jokes, but in truth, they're essential to any attempt at decor, and there's no reason why they shouldn't be simply stunning. At Lili Marlene's, a closet of a shop on busy Sixth Avenue, you can have one made to order or buy one ready-made. Shademaker/proprietor Linda Grove always has time to help customers wade through her swatchbooks of watered silks, textured linens, rice papers and leathers, with loving handiwork visible in every finished product. Grove also repairs worn shades and has unique pretties such as gathered violet silk or leopard-print mini-shades sitting on the shelf, ready to be taken home.

BEST ONE-OF-A-KIND FURNITURE

Rue 22

1307 22nd Ave.

Thank goodness the old Burlington Hotel didn't go up in a swoosh of bricks and dust, as originally planned. If it had been demolished, Denver might never have gotten a shop as delightful, eclectic and cozy as Rue 22. It starts with owner Barry Jelinski, a transplanted Texan who builds his own line of new-old, loft-friendly antiqued furniture. You'll find unique pieces at every turn, from one armchair upholstered with a circa-1700 Russian kilim to a pair of graceful, filigreed iron garden chairs dolled up with velvet tie-on cushions. But you'll also find blended seamlessly into the decor such items as Cartini glasses (what we call Matchbox chic, these rise from toy-car bases), a watchmaker's kit of impossibly tiny hardware, silvered flowerpots, unique folk art and a set of poodle knife rests. As if that weren't enough, the basement holds even more untold treasures.

BEST RUSTIC FURNITURE

El Paso Import Co.

723 S. Broadway

You don't have to search the alleys for rustic anymore--not with places like the El Paso Import Co. opening around town. A small, mostly Western-states chain, El Paso imports fabulous beat-up-but-like-new ranch-style and Spanish Colonial furniture from Mexico. A wander through the warehouse emporium uncovers wonderfully detailed provincial pieces--bureaus, wardrobes, tables and chairs painted in antiqued, worn colors, from lush verdigris green to weathered rust--with surprisingly reasonable price tags attached. Just the thing for your home on the range.

BEST FURNISHINGS FOR LUSH LIVERS

Djuna

221 Detroit St.

Djuna is a vast, rambling Cherry Creek showroom overstuffed with splendid antiques and things made to look antique, including pieces reupholstered in plush, old-look brocades, brass door knockers, collections of old buttons, cast-iron rods and finials, tin mantle shelves and crystal chandeliers. It could take hours just to wend your way through Djuna's heaps of stuff, waylaid at every turn by brocade and tapestry fabrics sold by the yard or arched-back black-cat floor mats and carved slices of wooden Victorian gingerbread. If your decorating tastes run rich, Djuna is for you.

BEST ARCHITECTURAL SALVAGE

Architectural Salvage, Inc.

1215 Delaware St.

You never know when you're going to need a sundial pedestal or a tombstone, do you? Architectural Salvage, Inc., is all business and filled to the rafters with gorgeous panes of old stained glass, etched brass doorknobs, carved mantelpieces, antique rocker cribs and huge marble slabs. Stacked in the middle are doors galore, and around the perimeter, you'll encounter window shutters, old sink basins and piles of glass bricks, all lifted right out of demolished homes. Don't be surprised if you go home with a pair of Dutch (they really are from Holland) doors with etched-glass details or a classic cast-iron dragon lamp. This place is a fixer-upper's paradise.

BEST CAST-IRON GATES

Metropolitan Antique Gallery

1147 Broadway

If ever you wanted to open the gates of Eden, the Metropolitan Antique Gallery is where you'd go to find them. Imagine locking your own garden in with a fifteen-foot-tall gateway of cherub-encrusted openwork that would look absolutely gorgeous draped in creeping heirloom roses or dripping with emerald ivy fronds. And why stop there? How about a marble angel birdbath or monumental bronze crane to go with it? Large, splashy and expensive is the theme here, from the splendid lost-garden fixtures outside to the stalactite-like display of crystal chandeliers hanging inside.

BEST LUMBER YARD CIRCA 1865

Hayden Forest Products

1600 Upper Bear Creek Rd., Evergreen

Any schmoe can pick up a two-by-four or sheet of particle board at a big-box hardware store. At Hayden Forest Products, folksinger and sawmill operator Tom Hayden provides an alternative for do-it-yourselfers more inclined toward Ye Olde Grizzly Adams workshop. Here is where you go to get hand-peeled lodgepole pines and slices of Ponderosa or to splurge on freshly cut spruce. Tucked inside an unspoiled forest valley just inside Clear Creek County, the Hayden family sawmill, with its original buildings and some machinery still intact, has been in operation for three generations.

BEST HANDY HANDYMEN

Handyman Express

www.handymanexpress.com

Ever wonder if finding a mate might be the solution to fixing that leaky faucet? Ever hear yourself sighing, "If only I had a husband"--and you're a guy? You need Handyman Express. It's easier than securing a spouse and a lot more headache-free. "If we can't fix it, we know who can!" is the motto of this clearinghouse started by former restaurant manager Andy Bell, who knows all about assembling a team of workers. And not only does Handyman Express know who, it knows when, which negates that most eternal of questions: Why do servicemen never show up when they say they're going to? (Second eternal question: Why do their drawers start dropping the minute they finally arrive?) The company offers a variety of services--from plumbing to furniture

repair to pest control to masonry--and promises to deliver several free estimates from pre-screened contractors before it delivers on the final job. So keep your pants on: Help is at hand.

BEST STORE AT DIA

U.S. Post Office

DIA Main Terminal, Level 6

If the U.S. Post Office seems like a funny winner for this category, go out to Tent World and take a look for yourself. What you'll mostly find is the same old stuff and chazerai you'd find at any other airport or, at the very least, in a bad corner of the mall. So you might as well go to the post office, which boasts a spacious philately boutique and very short lines. To its credit, you can find quickie gift items here, including Tweetie ties and other stamp-related Warner Bros. memorabilia. You can also mail off those bills you've been carrying around before you leave town or, on your return trip, make sure all of those postcards get mailed before you get home.

Readers' choice: Natural Wonders

BEST STORE AT CHERRY CREEK SHOPPING CENTER

Learningsmith

It's supposed to be a kids' store, but don't be surprised if you adults can't be torn away. True to its name, Learningsmith is in the business of shaping young minds by catering wisely to all age groups, from toddlers to teens. And there's a certain wisdom in the way the store is stocked: There are science projects galore, kid-sized musical instruments, books, building toys and videos alongside Wallace and Gromit merchandise and Arthur the Aardvark dolls. The friendly, service-oriented staff seems like a group of big kids themselves, and the store also offers special deals such as "Brain Bucks," awarded for good report cards, and a Frequent Buyer Software Club punch card.

Readers' choice: Neiman Marcus

BEST STORE AT PARK MEADOWS

Papyrus

Imagine a Hallmark store that doesn't smell like a vanilla candle and isn't sickly sweet, ersatz or the slightest bit cheesy. Papyrus, part of a gallery-like California-based chain, offers a deluge of gorgeous things that leave an enduring impression: high-end paper, Crane's stationery, organdy ribbon, stylish gift-wrap, nifty-gift curiosities and books, and cards, cards, cards--each designed to spark a smile or grace someone's day with beauty. Papyrus also brokers distinctive personalized stationery and invitations and insists on providing, along with an aesthetically pleasing shopping experience, a knowledgeable, helpful staff.

Readers' choice: Nordstrom

BEST SUPERSTORE

Half Price Store

Three metro locations

The Half Price Store is a suburban chain that offers clothing, toys, shoes, housewares and other items at bargain prices. In particular, the menswear and shoe departments are chock-full of value: Shirts with Polo and Nautica labels show up on $10 racks, and you can easily revamp your wardrobe for less than $100. The deal on cologne and perfume doesn't stink, either; while department stores routinely charge $40 for an ounce or two of

fancy scents, you can find well-known brands here for as little as $5. The merchandise available at the Half Price Store varies--depending on what batch of bargains has most recently come through the door, but that's part of the fun in shopping here. Such a deal!

Readers' choice: Kmart Super Centers

BEST OLD-FASHIONED SHOPPING CENTER

Bonnie Brae

700 block of South University Boulevard

Once upon a time, people did most of their shopping in neighborhood centers, strips of shops that lined a block or two. They'd pick up a few cut-to-order pork chops here, get a fan fixed there, maybe grab a snack while they waited for a haircut. While most of these strips surrendered long ago to suburban superstores, in Bonnie Brae, close to the fast-beating heart of the city, the shops still hark back to a slower time. For starters, there's the Bonnie Brae Tavern, once an outpost of comfort food on an unpaved road and still going strong--even though Denver has grown far beyond it. Cross the street for ice cream, liquor (can we carry that to your car for you?), gourmet-to-go at Cucina Leone (its intense hipness a fine contrast to the vintage Fifties storefronts a few doors down), hair care, clean shirts, pet and hobby supplies, flowers, the Saucy Noodle's overdose of garlic...and those pork chops. After a pit stop at the Campus Lounge for gringo chile, get a fill-up at the Conoco across University.

Readers' choice: Olde Town Arvada

BEST 16TH STREET MALL VENDOR

James Lawson

For the past one and a half years, James Lawson has plied his shoeshine trade along the mall and in office buildings throughout downtown. A gentle Jamaica native, he's quite willing to converse with customers on all sorts of subjects, although he doesn't force the conversation. Lawson's melodious accent and snappy commentary--speaking of a recent World Cup soccer game between his home country and Croatia, he remarked, "Ah, "'twas a beautiful, thrillin' match!"--are a delightful accompaniment to his expert daubing and shining. Lawson and his mobile shoeshine cart are always on the move but well worth seeking out.

Readers' choice: Tristan, the 50-cent hotdog guy

BEST PETS TO GO

Denver Dumb Friends League

Pet Careavan

671-5212

The Denver Dumb Friends League is on the road again. The organization has always used a mobile unit to ferry adoptable pets around town, but this year it christened a brand-new van, a tour-bus-sized vehicle with room for twelve kennels and easy walk-throughs by visitors. When you consider the thousands of homeless or abandoned pets that are overseen by the league and matched with new families each year, twelve animals at a time doesn't seem like much, but every little bit helps. And the Careavan concept is a successful one. In this case, seeing is believing: Once you climb aboard and find yourself face-to-wet-nose with an affectionate little cocker spaniel, are you really going to say no?

BEST PLACE FOR PETS WHEN THEY GO

Evergreen Pet Cemetery and Crematorium

26624 N. Turkey Creek Rd., Evergreen

Fluffy's gone, and you can't bear to part with him just yet. But local ordinances won't allow you to bury him in the backyard under that apple tree he loved so much, the one he used to sharpen his claws on, the one he always scurried up to gnaw on the necks of innocent robins. Evergreen Pet Cemetery and Crematorium can help you get Fluffy to his final resting place. One option is to have them bury him in their peaceful, flower-riddled meadow--a fenced property that looks out onto the wild game preserve on which buffalo, deer and elk roam--complete with a headstone or monument. Or you can have Fluffy cremated and lovingly placed in the pet vault or sealed in a container of your choice for your own private sendoff. Whatever you do, don't sneeze on the way home, or Fluffy could end up in the bad karma of Highway 285.

BEST PLACE TO GET YOUR PUPPY FIXED

MaxFund Veterinary Hospital

1041 Galapago St.

You already know the MaxFund. It's a no-kill shelter with a laissez-faire attitude about housing homeless and castoff pets and a strict one when it comes to arranging the right adoption. But now there's also a full-service veterinary clinic devoted to keeping pets in the pink at the fund's Galapago Street headquarters. Aside from providing low-cost spay/neuters and pet health care that its clients (both animal and human) will swear by, the clinic is also the only one in town to offer a therapy pool where injured mutts can tone their achey muscles back into shape.

BEST PLACE TO GET YOUR RUG FIXED

Sarkisian's Oriental Rugs

693 E. Speer Blvd.

No, it's not the Hair Club for Men--it's Sarkisian's! As long as the pricey Speer Boulevard antiques dealer stays in the biz, there's no need to let that hole in your Persian fray and unravel completely. The artist-weavers at Sarkisian's will match your carpet's pattern and colors, thread by thread, while they work their rug-repair magic. And when they're through, you'll be able to move that potted palm off the rug and back into the corner where it belongs.

BEST PLACE TO GET FLOCKED

Paulino Gardens

6280 Broadway

Fawning over festively flocked flora? While still offering the standard white flocked trees that Mom so adores, Paulino's sells flocked trees in red, orange, aqua, blue, purple and yellow to brighten any room. Tinted trees come in several sizes--from tabletop to well over six feet--and multi-colored wreaths are available, too. So what are hue waiting for?

BEST PLACE TO PLAN YOUR GARDEN

Denver Water Department Gardens

1600 W. 12th Ave.

Before you hit the gardening superstores, take a trip to Denver Water's administrative headquarters. Park in the visitors' lot and check out the xeriscape display, which features a wide array of flowers, grasses, shrubs and trees--an oasis of creeping Colorado grape holly, dragon's blood sedum, and dozens of other colorful but water-conserving plants. Russian sage or Harold's pink daylily? This is a great place to wander and ponder your next adventure in landscaping.

BEST FREE GARDENING HELP

Planttalk

1-888-666-3063

Just about every organization that knows anything about gardening in these parts--the Denver Botanic Gardens, CSU Cooperative Extension and Green Industries of Colorado, in this case--joined forces to provide this 24-hour information call-in line on horticultural topics. So when your tomatoes look limp or your yard begins to resemble The Day of the Triffids, don't despair--drop Planttalk a line instead. If the service's menu of topics doesn't suit your toughest garden problems, there are also live operators available from 9 to 3 weekdays who can refer the stickiest questions to the proper gardening authorities.

BEST SEEDS

Botanical Interests, Inc.

Seeds are so wonderfully mysterious--stick some in the ground and they cheerfully poke their green heads up through the soil days later, as if answering some kind of inner snake-charmer's tune you've been broadcasting in your sleep. Botanical Interests, Inc., adds to the experience first and foremost by providing an interesting and varied selection of quality flower and vegetable seeds suitable for every sort of garden, large or small. But they spice up their product by merchandising it in beautifully illustrated packets (available at metro-area garden centers) with a wealth of growing information printed inside and out. Any question you could possibly have about the cultivation and care of each type of seed is answered--and then some. Have we planted any ideas for you?

BEST PLACE TO BUY A BIRDHOUSE

Echter's Greenhouse & Gardens

5150 Garrison St., Arvada

Looking for real estate? Maybe a small investment? From a dormitory-style long house to the proverbial sunny garden apartment, Echter's has birdhouses and feeders, including rustic, modern, functional and squirrel-deterring models. The best time to shop Echter's for an avian abode is in the off-season, when more space is given over to this imaginative stock, but you can still get the most serviceable models--along with appropriate feed--year-round. And if you're a real nature-lover, check out the squirrel feeders. When it comes to those acrobatic yard rats, we've found that the only way to prevent them from raiding the bird-chow diner is to give them a taste of their own gourmet pickin's. It's nutty, we know, but it works.

BEST GARDEN TOOLS

Birdsall & Co.

1540 S. Broadway

You'll find gleaming wooden handles and handcrafted blades on the tools at Birdsall, where everything should be thought of as a lasting investment--including the exasperatingly single-purpose asparagus knives. In

addition, the shop sells an elegant line of teak patio furniture, as well as statuary and fountains, copper plant markers, oak-leaf stepping stones, brass verdigris animal faucets and the cutest little hedgehog-shaped terra-cotta pot feet you'll ever see. Dig in.

BEST POTTED PLANTS

Wild Flowers

1201 Madison Ave.

A potted plant is a potted plant--not. What we hate is when that gorgeous foliage you lovingly purchased in the nursery withers into crackling autumn leaves ten minutes before you reach home. At Wild Flowers, everything that leaves the store green mysteriously stays that way. Flowering plants--the miniature roses in particular--bloom like they're on plant Viagra.

BEST BOUQUET MAKINGS

The Perfect Petal

3615 W. 32nd Ave.

Walk into this big flower-and-gift shop--and keep walking. All the way back in the corner at the Perfect Petal, behind the racks and displays of dried greenery, scented soaps, greeting cards, sheep-fleece kids caps, sculptural Italian garden urns and Jordan-almond-colored pastel pottery, you'll find some of the most fabulous fresh flowers in town. Everything in the case looks like it was cut minutes ago, including delicate branches bursting into pale-pink blossoms and a stunning collection of unusual hothouse blooms. The Petal also has a full-service florist for ready-made arrangements and unique corsages. This bud's for you.

BEST FAKE BOUQUET MAKINGS

Zync

246 Milwaukee St.

There's little chance of finding yourself in a jungle in arid Colorado--it's a fact that plant lovers here simply learn to live with. But Zync is out to change all that. The whole store is ablaze with blinding, eye-catching, fire-engine colors shooting out in all directions from fantastic artificial flora made in Southeast Asia. The carved wooden verdure comes in every species imaginable, from gaudy birds of paradise to precious mini-tulips, and can be done up in endless, dramatic combinations that will never drop, fade or wilt in your entryway. Buy an assortment and the friendly flower-tenders at Zync will do arrangements for free; bring a vase from home or purchase one there.

BEST TEPEES AND YURTS FOR YUPPIES

Advance Canvas Design

33 N. Uncompahgre Ave., Montrose

Haven't you heard? Tents are out. These days, cutting-edge campers prefer to go the way of the nomads. Montrose-based Advance Canvas Design makes tepees and yurts fit for a king, but commissioned by the stars (past clients include Ralph Lauren, Neil Young and Neil Diamond). Tepees are made of tightly woven, water-repellant canvas stretched over hand-peeled pine poles and reinforced with buffalo hides; they come in nine sizes ranging from 12 to 28 feet and cost between $500 and $2,000. Yurts, which have domed roofs and vertical walls, run even higher. "Yurts are a little more upscale," explains Dan Kigar, who started the company

with his wife, Emma, in 1976. The Kigars use modern materials and Mongol-horde know-how to create the traveling abodes, which include such contemporary conveniences as locks and windows. Ah, wilderness...

BEST COMPUTERS FOR THE IMAGE-CONSCIOUS

TechStyle

1150 Speer Blvd.

www.techstyle-com.com

You want to get a computer--you really do. But they're just so, you know, tacky. Those ugly plastic boxes just don't go with anything. Never fear: A Denver company has the solution you seek. TechStyle has developed a line of high-end, high-fashion computers that would look more appropriate in a Scandinavian Design showroom than on a shelf at Circuit City. Using flat-panel displays, sculpted metals, handmade wood exteriors and a healthy dash of snob appeal, TechStyle computers set themselves apart from assembly-line clones. The posh PC setups run between $4,500 and $10,000 for a complete system, but if that's out of your price range, you might want to go with a basic component or two: A wooden, ergonomically designed mouse will run you just $149.

BEST USED MACS

Media Guide Mac Center

777 Santa Fe Dr.

www.mediaguide.com

Whoever says Macs are a dying breed ought to drop by Media Guide and have their cynical eyes opened. The store is selling used Macs like--well, like hotcakes. A bare-bones enterprise that's joined a small influx of new businesses on Santa Fe Drive, Media Guide refurbishes, services and sells Apple products of every vintage, including the occasional near-new G-3, always emphasizing the company's user-friendly qualities as a selling point. It's a good place to pick up a heavy-duty word processor or game station for someone interested in pastimes other than Net-surfing, and computer novices can get their feet wet here without drowning.

BEST COMPUTER STORE FOR MAC USERS

Neighborhood Computer Store Inc.

18045 W. Alameda Ave., Lakewood

With practically every computer store in existence having capitulated to the demands of Microsoft's evil empire, what's a poor Macintosh lover to do? Head to the Neighborhood Computer Store, Colorado's oldest and most respected Mac dealer. In business for nineteen years, the shop sells the full line of Apple products, from the newest laptop to the top twenty best-selling Mac software titles. Also in stock are plugs, wires, toner and other accessories that seem unimportant until you discover you can't do anything without them. As a bonus, the repair department works exclusively on Macs and can usually get machines back to their owners in three business days. Take that, Bill Gates.

BEST PLACE TO BUY USED CDS ONLINE

Second Spin

www.secondspin.com

There are few joys in life equal to the pleasure of scouring the used-CD bin--if you happen to be a certified masochist, that is. Even if you can stand jostling other bargain-hunters for position in narrow record-store aisles and listening to the maddening clack-clack-clack of jewel cases being flipped, there's no guarantee you'll find that sonic gem. Second Spin offers an easier way. An offshoot of Denver's Famous Video and Music, this database allows you to buy used CDs online. Because it's a database, it's easy to search and lets you clearly see prices (which average from $5.99 to $7.99). Second Spin also lets you sell CDs on their site, offering sellers a better-than-average price. And there's an added benefit: no snotty teenage salesclerks to deal with.

BEST MUSIC STORE

Golden Music Center

2430 East Street, Golden

The Golden Music Center, owned by longtime Denver performers Mike Roller and Mary Brainerd, is geared toward teaching, with five soundproof music studios and a staff of eighteen instructors, most of whom are working professional musicians and recording artists. Classes are available for a wide range of instruments, from trumpet and violin to piano, drums and guitar. There's a nice assortment of instruments for sale and rental, and prices are competitive with mail-order and discount chains. The music center is tucked a little bit out of the way, but it's worth the effort if you're serious about music.

BEST PLACE TO BUY A SITAR

Aeolian Art & Music Center

9646 E. Arapahoe Rd., Englewood

Seeking things that go twang in the night? Then hurry to Aeolian Art & Music Center, where exotica mingles on the walls alongside the usual electric guitars. Take your pick from ornate sitars and sarods, tablas and zithers, some of which are remarkably inexpensive considering the evident workmanship. And should you decide to buy one of the strange and beautiful instruments, Aeolian offers lessons so you can learn how to play it, too.

BEST RECYLCED INSTRUMENTS

Music Go Round

8055 W. Bowles Ave., Littleton

Music Go Round, a national chain owned by the retailers who created Play It Again Sports and Computer Renaissance, offers used instruments and other music-related goods for about half the price of new equipment. The store pays cash for used instruments and then spruces them up for resale. This concept is especially useful for younger musicians (not to mention paying parents) who may decide to trade in the trumpet for the xylophone or play soccer instead of violin.

BEST USED RECORD STORE

Don's Discs

8858 N. Washington St., Thornton

Records--remember them? Black vinyl circles, twelve inches across, with paper labels on either side and a hole in the middle? Well, Don's Discs has an incredible assortment of them--sought-after collector's items,

singles whose prices start at a quarter, and oddities so odd that any decent collection would be incomplete without them.

BEST USED CD STORE

Twist & Shout

300 E. Alameda Ave.

Twist & Shout has a wall of used CDs. A big wall. A huge wall. The store is also loaded with a grand selection of new national and local recordings, boxed sets, vinyl and assorted odds and ends, and its generous listening area allows you to try before you buy. But budget-minded consumers will probably be most impressed by the aforementioned wall, because size does matter.

BEST NEW CD STORE

Wax Trax

626 E. 13th Ave.

This music mini-mall, which has taken over the better part of a block, doesn't stock every CD known to man, and it's just possible that the clerks who work there won't be able to track down some of the more obscure recordings to have been issued this century. But if anyone can find it, Wax Trax can. And in this day and age of chain-store conformity, that's strangely reassuring.

BEST VIDEO STORE

The Video Station

1661 28th St., Boulder

Where else in the Western Hemisphere (much less Boulder) will you find 30,000 titles, from The Godfather to Leningrad Cowboys? This sublime video source specializes in the exotic: How about five 1972 episodes of the Mike Douglas Show guest-hosted by John Lennon and Yoko Ono? Or obscure Felliniana like Variety Lights? It's stuff that most other stores have never heard of. The Video Station also stocks 800 high-tech DVD titles, including Timothy Leary's Dead and My Night at Maude's. Just for Denverites: Saturday-Monday rentals at the one-day rate of three bucks.

BEST ALTERNATIVE VIDEO STORE

Across the Trax

624 S. 13th Ave.

A part of the always-growing Wax Trax family, Across the Trax features a small but unusual collection of videotapes. Besides dozens of rock videos, the store carries an eccentric collection of cult movies, science fiction, Japanese animation--even fetish films on topics like tickling. Foreign directors such as Tarkovsky, Bunuel and Almodovar are also well-represented, and rental rates are reasonable. If you're bored with your local Blockbuster, Across the Trax could be your alternative ticket.

BEST ADULT VIDEO STORE

Universal Video's Las Vegas Adult Video Palace

2070 S. Havana St., Aurora

Clean, well-lit and non-threatening, the Las Vegas Adult Video Palace provides an almost wholesome environment in which to browse for pornographic movies. Don't worry, though: Just because it's not seedy doesn't mean the Palace doesn't have everything you porn dogs desire. But with a number of regular family films, too, it's like the Blockbuster of the adult entertainment world. Bring the kids!

BEST QUICK ART DIP

Art Students League

Summer Samplers

200 Grant St.

Immerse yourself. That's the message the Art Students League wants to make with its Summer Samplers, a series of one-day art workshops that give you a taste of whatever artsy medium might catch your fancy. Taught by experienced artist-instructors, the workshops offer an overview of more in-depth league classes offered all year. Best of all, if you decide it's not for you, it's not like you're in first grade again--you don't have to go back.

BEST PLACE FOR ARTISTS TO FIND TREASURES

Meininger's Garage Sales

499 Broadway

When it moved to swanky new digs on Broadway, the H.R. Meininger Co. losts its garage, but the art-supply store continues to hold occasional garage sales. For artists who like planning ahead--and can afford to buy in bulk--the sales are the perfect opportunity to find great deals on those necessary, and pricey, supplies, as well as unearth the occasional treasure.

BEST TREASURE CHEST AND ART GALLERY

Me L Yu

107 Broadway

"Me L Yu" is owner-designer Paula Bennett's cute way of saying "the place where you live," and the objects you'll find here are hell-bent on providing you with artistic ways of imbuing your environment with a highly personal vision. Old pieces, such as embossed copper platters, tapestry quilts and magnificent two-foot-tall antique candlesticks appropriate for a haunted mansion, are mixed in with artists' pieces: pastels by Susan Planalp, a slick shark table by Bill Gian, Janet Austin's mosaic wall pieces, Joan Robey's lamps, Ginger Valone's painted wood mirrors, even a blue-green copper coffee table shaped like a hollow stump that houses tiny blue robin's eggs, nests, a doll's head and a brass robin. Live it up--and be at home with yourself.

BEST STUDIOS FOR HIRE

Workshops

4340 E. Kentucky Ave., Glendale

Everybody craves a room of one's own; finding it is the hard part. But Workshops, a warehouse of an affair tucked away in the middle of Glendale, serves no other purpose than to provide space. Its leasable studios--a floor, four walls, a phone jack, and natural and fluorescent lighting--range in size from approximately 65 to 300 square feet and rent for $95 to $380 a month. And what you decide to use one for--reading room, Internet cave, wood shop or painter's garret--is strictly your own business.

LOAD-DATE: June 26, 1998

Evidentiary Exhibit Number 133

Detroit Free Press
Found on Freep.com

Detroit Free Press
June 21, 1998 Sunday METRO FINAL EDITION
Correction Appended

SECTION: REAL ESTATE; Pg. 1J
LENGTH: 1447 words
HEADLINE: SAVING STRATEGIES CHANGING YOUR LIFESTYLE JUST A LITTLE CAN ADD UP / TO A DOWN PAYMENT FOR YOUR FIRST HOME
BYLINE: EBONI JOHNSON Free Press Real Estate Writer
BODY:

So you're ready to buy your first home and it's going to cost about $100,000, but you can't figure out how you're going to save the $5,000 just for the down payment. That doesn't include your pre-paid taxes and closing costs, which add another couple of thousand dollars.

A year ago, Jennifer Watt was in that situation. She saved her down payment by living with her parents for about nine months.

"I gave my rent check to my mom and she put it in the bank," Watt says. She says living with her parents was like being in high school again, but it was the only way she could save a down payment quickly. "It meant a lot for me to have my own house. I couldn't rent anymore. It was something I had to do."

She closed on a $70,000 two-bedroom ranch in St. Clair Shores in February by saving about $500 a month.

Here are real-life strategies for saving to become a home owner. Keep in mind that you may need to combine some of the these methods to save what you need.

Category 1:

Raise more money

GET A PART-TIME JOB: At $6 per hour, for 15 hours a week, you could make an extra $90 (gross) per month. That's $4,680 in a year.

Disadvantages: You won't have as much leisure time.

ACCEPT A RELATIVE'S CASH GIFT.

Disadvantages: Some lenders require your down payment to come from your own funds. They'll need proof that you earned the money or a gift letter, which says you don't have to pay it back.

Professional advice: Senior account executive Linda Young of John Adams Mortgage Co. says: "Most of the time what I find with buyers is that they wait until the last minute and go to relatives for gifts, ask for seller contributions or deposit paychecks."

HAVE A YARD SALE OR SELL A SECOND CAR.

Disadvantages: A yard sale can be time-consuming and slow, depending on how well you advertise -- and you often don't sell everything. If you really need your second car to keep miles low on a leased car, for example, selling it could cost you.

Real-life saver: Realtor Chris Cetlinski bought his first home in Boston-Edison in Detroit by having a yard sale that lasted four or five days. He owned a gift shop before the sale, so he had a lot of decorative items and kitchenware. "I put out a lot of good things because I realized if I wanted to make some money I had to give up some of the items."

Cetlinski says he made nearly $7,000 from the sale and put $10,000 down on a $47,000 home. The most expensive item he sold was an oil painting for $600.

Category 2:

Use found money

SET ASIDE BONUS CHECKS.

Disadvantages: If you budget your bills based on regular commissions and bonuses, you won't save.

Real-life saver: Doug and Allison Cohen used commission check bonuses to fund the down payment for their new $145,000 colonial in Waterford Township. They also sold some stock and trimmed their spending, by cutting back on manicures and compact discs, for instance. In just two months, they were able to save $15,000.

USE YOUR TAX REFUND.

Last year, the average federal income tax refund check was about $1,195 in Michigan, according to Elcy Maccani, communications specialist for the Internal Revenue Service.

Disadvantages: It probably will not be enough to finance your entire down payment.

RENT TO OWN.

Finding a rental you'd like to own and asking the owner if all or part of your rent can go toward a purchase is a painless way to save. It's also a way to get to know the neighborhood and property before you buy.

Disadvantages: You may decide you don't like the neighborhood or the house and you'll lose the portion of your rent that went to the down payment. "With renting to own, you don't have much legal power at all. If the owner passed away, for example, you wouldn't own the house," says Regina Morgan, a real estate and lending consultant with Global Real Estate.

BORROW AGAINST YOUR 401(K).

Disadvantages: You probably will have to wait to accumulate at least $500 before you can borrow, and usually you are only allowed to take out half. Plus, you're taking the money out of your retirement fund. Ralph Roberts, of Ralph Roberts Real Estate and First Mortgage America, advises that you make sure to borrow enough, because with some 401(k) plans you can only take out one loan at a time. With others, you can take out between two and five, according to Marceyle Ziemba, a communications associate with the Vanguard Group. It's best to check with your particular 401(k) savings plan.

Professional advice: Realtor Karl Lucas of Century 21 Town and Country in West Bloomfield says: "It sometimes takes three or four weeks to borrow from a 401(k), so make sure to leave enough time from the time you start looking to the time you close to get the cash."

Category 3:

Spend less

TRANSFER HIGH-INTEREST CREDIT CARD BALANCES TO A CARD WITH A LOW APR.

Hunt for rates as low as 5.9 or 3.9 percent. Your combined monthly minimum payment should be less than the total for multiple credit cards -- and you can save the difference toward your down payment.

Disadvantages: The low rates offered by these credit cards usually have a time limit, sometimes as short as three months, making it impossible to pay off the entire balance before the rates creep up. Be sure you read the fine print.

Professional advice: Louise Guyton, assistant vice president of public affairs with Comerica Inc., says: "I always tell first-time home buyers to first establish the amount you want to save. Work with your mortgage professional and find out how much you can afford. They can tell you how much is needed for a down payment and closing costs. You need to have a goal."

Guyton's advice is to consolidate and close as much debt as possible and apply that monthly payment to your savings. "If you have eight credit cards and pay about $500 a month total, consolidate those credit cards into one with a low interest rate. It also helps reduce your debt-to-income ratio." That will help you qualify for a mortgage.

CUT YOUR UTILITY BILLS.

Disconnect the cable TV. Simplify your phone service by cutting off caller ID, call waiting, three-way service, etc. Limit your long-distance phone use. Turn off the air-conditioning.

Disadvantages: You might miss all your extras.

Real-life saver: Christine Young saved for the $33,000 Detroit ranch she and her husband, Marvin, live in using several methods. "I put in a lot of overtime at my job. I opened a Christmas savings account with a 6-percent interest rate (in March 1995), which allowed me to make deposits, unlike a CD where you need a substantial amount down. I stayed with my fiance and his mother from November to February and saved my rent -- about $400 per month." She closed on the house in February 1996 with $2,400 down.

Young says when they wanted to go out to eat, they'd satisfy their craving at the grocery store. "If we craved Ponderosa, we'd buy two T-bone steaks, potatoes and a salad. Then we'd set the table like we were at the restaurant."

GET A ROOMMATE OR LIVE WITH RELATIVES.

If you pay $500 per month in rent, a roommate could save you $3,000 in a year.

Disadvantages: You'll sacrifice privacy. And you'll need to make sure you don't find other ways to spend your rent money.

CUT INCIDENTALS.

Professional advice: Mark Rosen, community relations manager at Credit Counseling Centers, a nonprofit organization certified by HUD that offers housing and financial counseling, says some lenders require borrowers to have credit counseling before they can qualify for a loan. "The first thing we discuss with clients is their value system, their current spending plan. We talk about goals and achievements, short- and long-term.

"The first step is developing a budget, looking at your income and all your expenses and seeing where you can save money. We establish categories -- entertainment, food, utilities, etc. -- and gauge what is going into each."

Rosen offers ways to cut your spending:

Be careful when you use credit; use cash whenever possible.

Use the phone on weekends and evenings instead of during the day.

Use generic brand foods, cleaners and medicine.

Use a list when shopping so you don't buy unneeded things.

Go to a beauty college to get haircuts at a minimal charge.

If you would like help with budgeting from Credit Counseling Centers, call 1-800-547-5005 anytime. If your school or house of worship would like to set up a money management workshop with Credit Counseling Centers, call 1-248-553-5400, ext. 447 anytime.

Real estate writer Eboni Johnson can be reached at 1-313-222-6512 or by E-mail at realestate@det-freepress.com

NOTES: CORRECTION RAN June 23, 1998

CORRECTION-DATE: June 23, 1998

CORRECTION:

In Sunday's Real Estate section, an article about saving for a down payment for a house contained a miscalculation. It should have said it takes a week to earn $90 if a person making $6 an hour works 15 hours a week.

GRAPHIC: Photo TOM PIDGEON, Special to the Free Press;

Marvin and Christine Young found several ways to save for the down payment on the house they've lived in since 1996. Below, the Youngs hold hands in front of the northwest Detroit ranch.

LOAD-DATE: October 17, 2002

Evidentiary Exhibit Number 134

The Washington Post

May 10, 1998, Sunday, Final Edition

SECTION: LOUDOUN EXTRA; Pg. V01

LENGTH: 825 words

HEADLINE: Rent Controls to End at Low-Income Complex; Leesburg Village Rents to Rise

BYLINE: Susan Saulny, Washington Post Staff Writer

BODY:

Rent controls that have provided affordable housing to tenants of Leesburg Village, one of three Loudoun County apartment complexes for low-income families, will be lifted soon, with the expiration of a 20-year deal between the federal government and the builder.

Rent controls also may be lifted this fall at Loudoun House, another low-income complex in Leesburg, if the builder does not renew its federal Housing Assistance Payment contract in September or decides to sell the property.

At a news conference Friday, Cindy L. Mester, the county's director of housing services, said federal rent subsidies will be available to help eligible tenants remain in their apartments.

Rents at the Leesburg Village apartments on Plaza Street, now about $ 440 for a two-bedroom apartment, could nearly double after the owners sell the property at the end of this month. KSI Services Inc., based in Vienna, has a contract on the property and intends to renovate it -- inside and out -- over the next two years, Mester said.

The same company has expressed interest in buying Loudoun House, but no agreement has been reached, according to company officials. Loudoun House has 248 units.

Both complexes were built under a funding mechanism that Congress set up 20 years ago to boost the number of affordable housing units nationwide. Through the Department of Housing and Urban Development, low-interest mortgages were issued to developers who agreed to control rents for low-income tenants for 20 years.

Now that the 20 years are up, the owner of Leesburg Village, Leesburg Village Associates, is exercising its option to pay off the rest of its mortgage and sell the property. The owners of Loudoun House have not decided whether to renew the rent-control agreement, pay off the mortgage or sell.

Mester said Leesburg Village tenants whose incomes does not exceed 80 percent of the median for the area will qualify for federal "preservation vouchers" that would allow them to remain in their apartments.

Tenants would be charged 30 percent of their income for rent; the vouchers, administered by the county, would make up the difference between that amount and a fair-market rent.

Tenants at Leesburg Village, which is almost completely full, also could choose to move and use their housing vouchers elsewhere.

Mester said the voucher program was created earlier in this decade when it was clear that 20 years had not been long enough to solve the affordable housing crisis. "At the end of these 20-year periods, there was a risk of a national crisis because so many affordable housing units were being eliminated," she said.

Leesburg Village's 156 apartments are home to a large number of elderly residents, as well as young families with children. After the sale and a large-scale renovation, rent is expected to be at full market value -- in the $ 700 range for a two-bedroom apartment.

The voucher program "fits in with our goal to keep as much of the current tenant population as we can," said Greg Lamb, KSI's director of multifamily development.

"The residents here have a lot of respect for the property. That's why we find it imperative . . . to allow people to move back into their units [after the sale and renovation]."

KSI plans to spend $ 15,000 per unit on things such as paint, new kitchens and bathrooms, gutters, lighting and sidewalks.

But the inconvenience of moving out of an apartment while renovations are done and the risk of not qualifying for vouchers have caused some anxiety among residents.

Leesburg Village resident Lula Lawson, 60, who has lived in her apartment for 17 years, said: "I'm too upset to even talk about it. I don't know where I'll go or what I'll do. I can't sleep at night for worrying about what's going to happen."

John Lacy, 42, a postal employee, said there has been considerable confusion among residents about the pending changes.

Thursday afternoon, he and several neighbors tossed questions back and forth: "Who will qualify for vouchers? Can we all stay? I was told rent won't go over $ 700, but somebody else said $ 900. What's the income limit?"

Lacy said that he probably won't qualify for subsidies and that the new rent would be too much of a strain on his finances.

"I know I've got to go," he said. "I'm disappointed because they've been good to me here. I don't know yet what I'm going to do. I can't afford a place right at the moment." He said he might move in with his sister in Bealeton, in Fauquier County, until he saves enough money for his own place.

Leesburg Police Chief Keith Stiles applauded the pending sale because it will bring people with a mix of incomes to a troubled neighborhood in the northeast part of town.

"As chief of police, I'm excited about what you're bringing to Leesburg," he told a representative from KSI. "It takes more than the people and the police department. We really need your partnership on this."
LOAD-DATE: May 10, 1998

Evidentiary Exhibit Number 135

San Jose Mercury News (California)
May 2, 1998 Saturday MORNING FINAL EDITION
SECTION: REAL ESTATE; Pg. 2F
LENGTH: 1463 words
HEADLINE: COLLECTIVE SEEKS COOPERATIVE HOUSING
BYLINE: Mercury News Wire Services
BODY:

Q

For the past several months four of us have been meeting to discuss how to pool our financial resources to purchase a cooperative home. We have met with mortgage brokers, credit unions, real estate agents and attorneys. Finding experts on cooperative endeavors has proven to be difficult. Are there any existing cooperatives with information for us?

A

There are three books to consider: "Cohousing: A Contemporary Approach to Housing Ourselves" (Ten Speed Press, $29.95); "The Cohousing Handbook: Building a Place for Community" (Hartley and Marks, 24.95); and "Rebuilding Community in America" (Shared Living Resource Center, $24.50).

The Berkeley-based Shared Living Resource Center has been a leader in cooperative housing since the 1970s, offering workshops, consultation services and design services for a variety of cooperative housing needs. They range from large houses for communal living to "family living clusters," complexes of private bedroom suites clustered around a central kitchen-dining-living area, to "community village clusters" of homes around a central area.

The center is offering a tour on May 16 of five co-housing projects and cooperative communities in Davis, Sacramento and Berkeley. The all-day mobile workshop costs $50 and departs from the center at 8:30 a.m.

Make contact with Ken Norwood, center director, for more information and to order. The center is at 2337 Parker St. No. 9, Berkeley 94704; (510) 548-6608); e-mail slrcnorwood@igc.org ; Web site is http://www.citysearch.com/sfo/sharedliving .

-- Broderick Perkins
Mercury News
A
Have you considered each buying a percentage ownership? Obtaining a loan for four unrelated individuals for the same property is not difficult to obtain if you pool all of the incomes and they qualify for the monthly principal, interest, tax and insurance payments. A mortgage broker can pre-qualify or have you pre-approved before you go house hunting. Contact a tax professionals to discuss the tax consequences.

Stephanie Noryko,
Granite Financial
ADVANCE PAYMENTS MISAPPLIED
Q

Five years after we purchased our home, we began using certificates ofdeposit to overpay thousands of dollars per month on our mortgage. One payment was more than $8,000, but I discovered the lender was not applying these over payments until the next month's due date. I went to their main branch in Palo Alto and discussed this situation with their official. He assured me I was wrong and called the home branch to verify the statement. Finally, consumer advocate Chris Bjorkland of Seven On Your Side got involved and I received a letter from the lender stating they had no idea I wanted those extra thousands of dollars applied to our loan immediately upon receipt. They had been placing the money in some "suspense account" until the next month's due date. The lender also adjusted our account, subtracting $160 in lost interest. They assured us that they had not employed this practice in our prior monthly payments. Is this a common banking practice? If it is, imagine the billions of dollars sitting in these "suspense accounts" of just one lender.

A

It is distressing to hear this. Extra payments should be immediately applied to the principle. This is a warning that we should check our monthly statements or contact the lender to be assured that payments are credited in a timely manner. Many lenders suggest that you write two checks, one for the normal payment and one for the additional amount. Attach a note to the additional check stating that it should be applied immediately to the principal. Also, contact your lender and ask them to explain their policy and procedure for making extra payments. Attempt to obtain it in writing or get the person's name for future reference.

Stephanie Noryko,

Granite Financial

LOSS ON HOME SALE

Q

We had a home we rented out for eight years, until Oct. 31, 1996, when we moved into the residence. We've since listed the property for sale, but our agent advises us that we will suffer a net loss of about $25,000, even after recapturing the depreciation. Is there any way that we can recognize a tax loss on the sale?

A

Not in your case. It appears that you permanently converted your rental to a personal residence on Oct. 31, 1996, because it has been more than a year since your property has been a rental. You can deduct a loss from the sale of a rental, but not on a personal residence. If your intent was to temporarily live in the home while you were attempting to sell it, you might have a case to deduct the net loss of approximately $25,000. You should discuss your situation with a tax professional.

Marie E. Sternberger,

enrolled agent

USING STOCK TO BUY A HOME

Q

We are trying to compete in this crazy market and would like to include stock as part of the offer. What are the pros and cons of this plan for the buyer and the seller if we offer all the purchase price as stock? Should we offer more to compensate for the risk and cost of owning stock? Should we offer the list price in cash and as a deal sweetener, through in some stock, say $10,000 for each multiple offer on the table? We are particularly interested in how the tax would be calculated for property taxes and for capital gains on the sellers part.

A

What you propose is what the Internal Revenue Service considers bartering. You would recognize capital gains (from the sale of the stock) on the transaction. Your capital gain would be the increase in the fair market valueof

the stock over your cost basis in the stock. The seller's capital gain would be the difference between the cost basis in the house and the fair market value of the stock.

Let's assume that your cost basis in the stock is $100,000. The fair market value of the stock is currently $500,000. You would have capital gains of $400,000. If you owned the stock for 12 months or less, your gain would be taxed as ordinary income. If you owned the stock for 12 to 18 months, your gain would be taxed at 28 percent, 20 percent if you owned the stock for more than 18 months.

Property taxes are based on the sales price. Check with the tax assessor in your county for the exact calculation. This is an unusual transaction idea. I recommend that you consult with both a tax professional and a real estate professional before you begin.

Marie E. Sternberger,
enrolled agent

ROOM RENTAL AND CAPITAL GAINS TAX

Q

I have a large home with several empty rooms. If I rent out a room, how will this affect me when I decide to sell and move to a smaller home in a few years? Will I still qualify for the $250,000 exemption immediately since it is my principal residence? What other cost factors should I consider?

A

Your question has two components: the profit or loss from renting the room and the tax consequences of selling your home.

First, you must report the rental income. You can deduct some expenses related to the rented room and you can depreciate the rental portion of your home. Use Schedule E. You can deduct a percentage of your utilities, insurance, etc. based on the square footage of the rental space relative to your home's total square footage. For example if you have a 2,000 square foot home and rent a 200 square-foot room, you can deduct as rental expenses, 10 percent of your utilities, insurance, etc. on Schedule E. The remaining allowable deductions, 90 percent, go on your Schedule A as itemized deductions. You can also depreciate 10 percent of your home, but you should see a tax professional because the depreciation calculation is complicated.

As for the tax consequences when you sell, you will be entitled to the $250,000 tax exclusion on capital gains up to $250,000 ($500,000 for joint returns). You will, however, have to recapture (pay back) 25 percent of the depreciation that you have deducted.

Your situation warrants tax planning. I recommend that you consult with a tax professional before you begin renting out the room.

Marie E. Sternberger,
enrolled agent

UNDISCOVERED LIEN

Q

I bought a house and the escrow company missed a $20,000 lien on the property against the previous owner. The escrow company gave an insurance policy to the lender but did not give me one. What are my options here?

A

Without more details it's difficult to assist you. You did not say why an owner's policy wasn't issued, what the lien was for or how it was discovered. If the lender is insured under a title policy, then a prior lien would

compromise their security. It is also possible that you have some rights under the lender's title insurance policy. Go back to the escrow holder, who can refer you to the title insurer for more information.

Judi Souza,

Escrow Expertise

NOTES: IF YOU'RE INTERESTED

Mail questions to Broderick Perkins, Virtual Real Estate, San Jose Mercury News, 750 Ridder Park Drive, San Jose, Calif. 95190; fax (408) 271-3786; e-mail bperkins@sjmercury.com . Please include your full name, address and daytime telephone number.Virtual Real Estate

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Business Dateline;
Austin Business Journal
April 3, 1998

SECTION: Vol 18; No 5; pg 23
LENGTH: 1540 words
HEADLINE: Building investments A thriving economy and lack of available space has fueled a wave of building purchases in Austin
BYLINE: Matt Hudgins
DATELINE: Austin; TX; US; Southwest
BODY:

Nearly two dozen Austin office properties measuring more than 30,000 square feet each changed hands in 1997, and the count continues into 1998 with the recent sales of the 1 million-square-foot Austin Center downtown and the 300,000-square-foot Cielo Center in West Austin.

Full buildings pulling in premium rent have garnered some of the highest purchase prices in a decade, thanks to the ready coffers of stockholder or policy holder cash wielded by Real Estate Investment Trusts, insurance companies, pension funds and other institutional investors.

But how long will the wave of purchases continue? What will investors buy after the few remaining trophy properties are taken, and what will become of the real estate entrepreneur unable to beat the cheap cost of capital enjoyed by the institutions competing for the same properties?

A national trend

Real estate players say a strong economy and lack of available space is fueling intense buying and selling of real estate across the nation. Businesses growing under a strong economy demand more space, and that demand leads to higher rent and greater revenue for property owners. Owners following the principal of "buy low and sell high" try to sell when their properties are at their most valuable point, when occupancy and rent are at or near their maximum potential.

Added to that longstanding model is the relatively new addition of the real estate investment trusts, or REITs, that have great sums of Wall Street capital that must either be placed within a certain time frame or returned to stockholders. Reits have provided an eager market for many sellers seeking to cash in their real estate.

Investment brokers say Austin is probably enjoying more than its share of the fun because a growing number of national investors want footholds in the market, where high tech and a mix of other industries combine with a relatively affluent and educated populace to support an economy with long-term promise of growth.

And a good investment for office and retail properties.

Frank Niendorff, president of Commercial Industrial Properties Inc., says some institutional investors lower their size requirements when buying in Austin, although they are not likely to lower their requirements for a return on investment.

"In major market areas, REITs tend to limit purchases to a minimum of $ 5 million to $ 10 million," Niendorff says. But when a REIT or other institution decides to buy into a secondary market like Austin, it has fewer institutional-grade properties to choose from, and may take a smaller property than it would accept in a primary market like Houston or Dallas.

Niendorff says competition is pushing institutional investors to smaller markets.

"They can't find enough product to satisfy their appetite," he says. An investment group that contacted Niendorff earlier this year, for example, must place $ 200 million in anchored retail centers this year. He says he also is seeing more institutional money from foreign investors making its way into Texas real estate.

The national economy will continue to fuel investment by institutions, Niendorff says, because stock holders will keep buying shares in successful institutions and those entities must in turn place their shareholders capital in properties that generate a return.

He says the current cycle should last another two to three years, because it will take at least those two years for the supply of new space to catch up with demand. So long as there is a substantial gap between supply and demand, rents will keep climbing and the investment pattern will continue.

Greg Blackburn, a retail specialist at CB Commercial, sees a similar continuation in retail space investments, fueled by demands for space and rising rent.

Rental rates increased an average of 6 percent over the course of 1997, with a 30 percent climb in rates for space at regional retail centers. The rates for anchor tenants in new shopping centers jumped 28 percent, and non-anchor rates climbed 22 percent.

"Austin is growing faster than development," Blackburn says, and that should bring rates up an average of another 6 percent.

Blackburn says the owner of an attractive property may find investors calling even if the property is not designated for sale, and the offer may be too good to pass up. Further, he says some institutional investors may seek to acquire existing properties just because development in Austin requires too much time to suit their needs.

"We've not seen a REIT come into this town and buy some land and build a shopping center yet," Blackburn says. "They're more interested in something that's up and running. They need to place that money."

How long will it last?

Opinions vary on when this latest round of buying and selling will taper off, but Jerry Lumsden, senior vice president of CB Commercial, says most of the trophy properties - the principal target of national REITs - will be out of circulation for several years following recent ownership changes. That's because institutional investors, unlike entrepreneurs, make most of their money from shareholder investments rather than building sales. Now that Bridgepoint Square, Cielo Center, Austin Center and other premier addresses have sold to institutions, those investors are likely to hold their acquisitions for seven to 10 years before they are ready to resale.

"So there's a question of how much meat is left on the bone," Lumsden says.

In the early 1990s, buildings sold for as little as 30 percent of production costs and ratcheting rents yielded great returns, Lumsden says. Investors face a narrower potential for value enhancement by 1999, as sales prices that are nearing the cost of new construction yield narrower margins of return by 1999.

"It is still a good market as we speak, and the activity reflects that," Lumsden says. "But when we look beyond 1998 into '99 and the year 2000, the value may not be there, because we've reached a point that the value is at its apex."

Opportunities

Even if most of Austin's large properties go to institutional investors, real estate watchers say small properties will remain the domain of individuals and non-institutional investors for some time. And market events could trigger unexpected sales by institutional property holders.

To remain profitable, a REIT must maintain and increase its Funds From Operations, or FFO, says Laura Beuerlein, senior vice president of Heritage Title Co. of Austin. Without a good FFO to keep stockholders happy, a REIT won't be able to attract new investors to buy its stock.

"You really have to look at REITs like any other public company, like a security investment," she says.

That could mean that a catastrophe on Wall Street will drag real estate down with it, she says. If that happens, REITs may sell off property to raise capital, opening a window for others to step in and buy.

Laws restrict the amount of property institutional investors can sell in a year to about a tenth of their portfolio, Beuerlein says, but that changes if property acquired doesn't fit the criteria established for that REIT's portfolio. An institution acquiring inappropriate holdings through a merger, for example, may quickly sell off the incongruous parcels and reinvest the proceeds in its specialty properties.

Tom Stacy, president of T. Stacy and Associates and a partner in the ownership of several Class B office buildings downtown, is preparing for what he says will be the next wave of office building purchases.

Reits unable to find more Class A buildings to buy and improve values with rate hikes will turn to Class B buildings downtown, which now offer rates considerably less than A properties, particularly downtown, and leave plenty of room for enhancing value. Class B rents will rise nearer to, but still below, Class A rates and tenants leaving the pricey Class A buildings will increase demand for B space, Stacy says.

"That's the opportunity for REITs," he says. "We'll see a wave of REITs that are not household names buying in Downtown Austin, probably all over Austin.

"It's hard to find opportunities we can buy that have the entrepreneurial returns that we've been able to do in the past," Stacy says. "That's the challenge that I have, trying to find deals that are undervalued, underutilized, like the Scarbrough Building, the Perry Brooks Building, that take a lot of imagination and a lot of risk. The REITs can't afford to take the kind of risk to bring the Perry Brooks Building back to the market place, whereas if we're successful in bringing it back, there will be a lot of interest from REITs or larger institutional owners that are willing to take less return but less risk than an entrepreneur will."

Beuerlein believes the next century will bring opportunities for local developers to take similar risks in putting new property on the ground for REITs unable to find appropriate properties. She says the phenomenon is already beginning to happen, citing as an example Sam Zell's Equity Residential partnering with Lincoln Property Co. to develop apartments.

"It's still a relationship business," she says, and REITs interested in development will turn to those who are here and know the market.

GRAPHIC: Photo

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Vanderbilt Law Review

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HEADLINE: Coping with "loss": A re-examination of sentencing federal economic crimes under the guidelines

BYLINE: Bowman, Frank O III

BODY:

I. INTRODUCTION

The primary determinant of sentence length for federal economic criminals is the amount of "loss" resulting from an offender's conduct.' The idea of basing sentences for economic crimes primarily on "loss" has become the source of ongoing, complex, and proliferating disputes about what the term "loss" really means and how it should be interpreted in particular cases. The "loss" calculation is one of the most frequently litigated issues in federal sentencing law.2 There are at present splits of opinion between the federal circuits on at least eleven analytically distinct issues concerning the meaning and application of the "loss" concept.3 Even more significant than the identifiable circuit splits is the overall sense of uncertainty, confusion, and sheer aggravation that emerges whenever lawyers and judges who deal with federal economic crime discuss "loss."4

As Special Counsel to the Sentencing Commission in 1995-96, I was asked to examine the Federal Sentencing Guidelines relating to economic crimes, as well as the cases and materials construing the term "loss," for the purpose of identifying the problem areas and determining whether some adjustments or definitional changes ought to be considered.5 Since leaving the Commission, I have continued to grapple with "loss." In the course of more than two years of reading "loss" opinions penned by puzzled federal judges, and talking with equally puzzled practitioners, several points have become clear.

First, the United States Sentencing Commission was undoubtedly correct in the basic judgment that the sentences of economic criminals should be determined in significant part by the magnitude and nature of the economic deprivation caused by their crimes.6 Where the original Commission fell short of the ideal was in the translation of a sound fundamental intuition into a just, doctrinally coherent, reasonably easy-to-interpret set of rules. Since the Federal Sentencing Guidelines ("Guidelines") first went into effect in 1987, the Commission has amended guidelines provisions regarding property crimes and "loss" many times.7 Regrettably, each amendment in the series has been a patch designed to fix one small component of a vehicle for sentencing economic criminals that was unwieldy and imperfectly designed to begin with.

Second, although it is possible to view the many problems with the existing economic crime guidelines as a collection of particular technical difficulties to be addressed individually, this approach has been tried and has proven the equivalent of trying to subdue an octopus one tentacle at a time. No patchwork fix will suffice. Only a virtually complete rewrite of the guidelines and application notes regarding theft and fraud offers any hope of significantly ameliorating the many problems of both substance and interpretation the current guidelines spawn so regularly.

This Article has three objectives. First, it attempts to rethink the sentencing of federal economic criminals in light of the basic purposes of sentencing and of the Guidelines' particular structure and objectives. Second, it

examines the deficiencies in the current sentencing guidelines regarding theft, fraud, and other economic crimes, and the problem areas in the case law construing those guidelines. Third, it proposes and analyzes a consolidated guideline, together with accompanying application notes, for sentencing virtually all theft and fraud cases (a draft of which follows the text of this Article as Appendix A).s

The economic harm resulting from a defendant's crime is an important factor in assessing offense seriousness, and therefore in assigning just punishments. The proposed consolidated guideline thus retains as a central component the concept of "loss." In addition, however, it identifies and accounts separately for other sentencing considerations that "loss" does not satisfactorily measure. In particular, the proposed guideline gives more attention to differences in mental state among defendants and attempts to place greater weight on harms not entirely captured in monetary measurements, such as the number of victims and the fact that identical monetary losses may have dramaticallY different effects on different victims.

The centerpiece of the reform proposed here is a redefinition of "loss." The current "definition" of loss is in truth no definition at all, but a hodgepodge of ill-fitting concepts drawn from such diverse sources as the elements of common law larceny and the remedies provisions of the law of contracts. Consistent with long-accepted principles of criminal liability and with the principles that animate the Guidelines themselves, loss should be redefined in terms of the required causal relationship between the defendant's criminal conduct and the pecuniary harms that result. A defendant should be held responsible at sentencing for economic harms that were caused in fact by his criminal conduct, and that were reasonably foreseeable by him.

In addition, because of the complex character of many federal economic crimes, establishing a doctrinally coherent core definition of loss is necessary but not sufficient to meet the practical needs of sentencing courts. Consequently, the proposed consolidated guideline goes further and sets out specific rules applying the core definition to particular problems such as the identity of the "victim(s)" of economic crime, the inclusion of interest, the time at which loss should be measured, the issue of a defendant's gain, and the question of net versus gross loss. Finally, the Article-and the proposed guideline address the most common difficulties posed by the concept of "intended loss."

I have no illusions that the proposals made here will be the last word on the punishment of federal economic crime, or even on the conundrum of "loss." The problem is too complicated and my powers too modest. However, there is good reason to believe that the Sentencing Commission is moving toward meaningful change. On October 15, 1997, and March 5, 1998, the Commission held public hearings on economic crime sentencing and the definition of loss.[9]

Representatives of the judiciary, the defense bar, probation officers, and the Department of Justice testified, and the proposals in this Article were placed before the Commission. Since the October hearing, Commission staff members have been working actively in collaboration with prosecutors, judges, probation officers, and the defense bar to develop a revised theft/fraud guideline for the Commission's consideration. Although as this Article goes to press the outcome of that process remains uncertain, I hope the suggestions contained in this Article will assist in producing an improved set of rules for sentencing the economic criminal.

II. THE FEDERAL SENTENCING GUIDELINES AND ECONOMIC CRIME: A PRIMER

A. The Role of Sentencing Purpose in Sentencing the Economic Criminal

A purely theoretical discussion about the punishment of crimes of dishonest acquisition might devote considerable space to the claims of competing philosophies of punishment, considering, for example, the relative merits of rehabilitation, retribution, deterrence, incapacitation, reprobation, and restitution. Likewise, an

abstract discussion might compare the relative virtues and demerits of determinate and indeterminate sentencing systems as vehicles for passing judgment on the economic criminal. However, the object here is not to write on a blank slate, but to analyze and propose improvements to an existing system. The analysis here works within the fundamental philosophical approach taken by the Guidelines, which is to say a virtual abandonment of the rehabilitative or medical model of sentencing[10] in favor of a designedly imprecise amalgam of "just deserts" retributivism and utilitarian "crime control" theories of deterrence and incapacitation.[11]

This is not, however, to suggest that considerations of purpose in sentencing must be abandoned except at the level of gross generality contained in Chapter One of the Guidelines.[12] Professor Marc Miller correctly insists that "(p)urposes ought to play a dominant role in shaping the sentence in each case."[13] In developing a guidelines system, this sensible admonition should manifest itself in two ways.

First, the Commission should carefully and explicitly consider sentencing purposes in creating the guidelines for each category of offense. Second, sentencing judges should consider purpose when setting an individual criminal's sentence within the range prescribed by the Guidelines.[14]

It is here that the Commission can sensibly be criticized for its work in creating (and repeatedly amending) the guidelines for the sentencing of economic crime. As we will see, the Guidelines account for a surprisingly large number of the factors one would want to see considered in sentencing of the economic criminal. The difficulty is that a failure to think through and articulate those sentencing purposes peculiar to economic crime has produced a package of sentencing provisions that is excellent in parts, but overall rather like Winston Churchill's description of an inferior pudding-"it has no theme."[15]

This Article proceeds from the following postulates, which are at the least consistent with the Sentencing Reform Act and the understandings of the framers of the Guidelines: (1) A criminal sentence should be no longer than morally justifiable by principles of just deserts; (2) the precise sentence below that maximum should be set by considering the utilitarian goals of deterrence, incapacitation, rehabilitation, restitution, and reprobation; and (3) which utilitarian goal will predominate will vary depending on the type of crime (and sometimes on the category of offender within crime type). The objective is not a universally applicable hierarchy of sentencing values. It is the articulation of sentencing rules with a rational connection to those sentencing purposes which predominate in each category of offense.[16]

B. The Centrality of Offense Seriousness to the Guidelines Regime

In describing its basic approach to drafting the Guidelines, the original Sentencing Commission emphasized the importance of retribution and crime control, but refused to "accord one primacy over the other" because, in the Commission's view, in most cases the two approaches produce roughly equal sentencing results.[17] The Commission was correct to this extent at least-both retributive and crime control sentencing theories ordinarily prescribe more stringent penalties for more serious crimes.[18] The retributivist says that one who commits a serious crime "deserves" a serious penalty. Likewise, the more serious the crime, the greater society's need to deter it. And by the logic of deterrence, the more severe the punishment, the greater the deterrent effect, both general and specific. Similarly, where there is a risk of recidivism, the more serious the crime, the more acute is the need to incapacitate the criminal and thereby protect the public from future transgressions. Finally, if one considers reprobation a separate justification for punishment (rather than merely a description of a type of general deterrence or an explanation of why the public shaming component of punishment is deserved), a scheme that gives powerful object lessons in the community's shared values by imposing stern penalties for notably reprehensible crimes also serves reprobative ends.[19] Thus, a prerequisite to implementation of all these objectives in a guidelines regime is the creation of a means of measuring the seriousness of offenses.[20]

A crime occurs when there is a volitional act attended by a culpable mental state which causes, or at least risks causing, a harm.21 All these concepts-act, mental state, cause, and harm-are relevant both to the threshold question of the existence of criminal liability and to the assessment of offense seriousness.22 When we rank the severity of crimes, we focus not on any one of these elements, but on their interaction. Likewise, the relative importance of the basic components of criminal liability to judgments about offense seriousness varies among different categories of crime. For example, all grades of homicide are directed at the same harm, the death of a human being.23 The difference between the statutory degrees of homicide is almost purely a question of culpable mental state. By contrast, the mental state of all larcenies (and indeed of most simple property crimes) is some variant of an intent to permanently deprive an owner of his property; historically, statutory grades of the offense differ according to the value of the property stolen, a factor predominantly related to harm.24

Both when discussing the imposition of criminal liability and when ranking offense seriousness, we tend to lump the first three components of a crime-act, mental state, and cause-into the single concept of fault or blameworthiness.2 The idea of fault often embraces still another consideration-those circumstances or characteristics of the individual defendant relevant to his capacity or disposition to make culpable choices. The question of individual capacities and circumstances arises both in determining the existence of any criminal liability (as in the case of insanity26) and in assessing offense seriousness and appropriate punishment (as with diminished mental capacity27 and voluntary intoxication,28 which often mitigate offense severity even where they are not complete defenses to liability).

Moreover, judges have historically considered many of a defendant's personal characteristics-age, family history, socioeconomic background, mental condition short of insanity, alcohol or drug addiction, physical condition, educational level, employment history, family responsibilities, and the like-that are relevant to the choice of sentence within the legally allowable range because these characteristics have been thought to render a defendant more or less blameworthy for his bad choices and the resultant harms.29

A guidelines sentencing system whose philosophical underpinnings confer pivotal importance on offense seriousness must, therefore, contain mechanisms to account for harm (including risk of harm) and the four components of fault (act, mental state, cause, and responsibility) as they manifest themselves and interact in different categories of crime.30

C. The General Structure of the Guidelines

The Federal Sentencing Guidelines are, in a sense, nothing more than a set of instructions for one chart-the Sentencing Table.gl The goal of guidelines calculations is to arrive at numbers for the vertical (offense level) and horizontal (criminal history category) axes on the Sentencing Table grid, which in turn generate an intersection in the body of the grid. Each such intersection designates a sentencing range expressed in months. For example, a defendant whose offense level is 26 and whose criminal history category is I would be subject to a sentencing range of 63-78 months.32

The criminal history calculation reflected on the horizontal axis of the Sentencing Table is a rough effort to determine a defendant's disposition to criminality, as indicated by the number and nature of his prior contacts with the criminal law. The basic unit of measurement in this calculation is prior sentences imposed for misdemeanors and felonies.33

The offense level reflected on the vertical axis of the Sentencing Table is a measurement of the seriousness of the present crime. In general, the offense level calculation begins with the crime of which the defendant was actually convicted. The court must determine, primarily by reference to the "Statutory Index,"34 which guideline in Chapter Two ("Offense Conduct") applies to that crime.

Most Chapter Two offense conduct guidelines contain two basic components: a "base offense level"-a seriousness ranking based purely on the fact of conviction for a particular statutory violation-and a set of "specific offense characteristics." The "specific offense characteristics" represent an effort to categorize and account for commonly occurring factors that cause us to think of one crime as worse than another. They "customize" the crime. For example, the Guidelines differentiate between a theft of $ 1,000 and a theft of $ 1,000,000,35 or between a bank robbery where the robber hands the teller a note, and a robbery where the robber pistol whips the teller and shoots the bank guard.36

Once the court determines an offense level by applying the offense conduct rules from Chapter Two, it considers a series of other possible adjustments contained in Chapter Three. These include increases in the offense level based on factors such as the defendant's role in the offense,37 whether the defendant engaged in obstruction of justice,3 commission of an offense against a government official39 or a particularly vulnerable victim,40 and the existence of multiple counts of conviction? The court may also reduce the offense level based on a defendant's "mitigating role" in the offense42 or on his so-called "acceptance of responsibility."43

Once the court has determined the offense level on the vertical axis and the criminal history category on the horizontal axis, it can determine the sentencing range. The judge retains largely unfettered discretion to sentence within that range.? However, in order to go above or below the range, to "depart," the judge must explain why, and must couch the explanation in terms of factors for which the Guidelines do not adequately account already.45 Moreover, except in unusual circumstances, the Guidelines specifically exclude from consideration, for purposes of departing outside the guideline range, most of those factors, such as age, employment record, or family ties, that judges formerly used to individualize sentences.?

Finally, the Sentencing Commission created "relevant conduct."47 A thorough discussion of relevant conduct is beyond the scope of this Article, but the essence of the concept is that the court can, indeed must, sentence each defendant based on what he really did as part of the same transaction or series of related transactions that resulted in the count of conviction, regardless of the specific offense of which a defendant is convicted after trial or as a result of a plea.

The inclusion in the Guidelines of the relevant conduct concept, the customization of sentences through "specific offense characteristics" not included in the elements of the offense of conviction, and the rules governing sentences for multiple counts of conviction, when taken together, transformed what would otherwise have been a predominantly "charge of conviction" system into a "modified real offense" system 48 The "modified real offense" character of the system is of considerable importance in understanding the Guidelines' approach to sentencing economic crimes.

In general, therefore, and consistent with their philosophical premises, the Federal Sentencing Guidelines focus pervasively on offense seriousness. The explicit numerical yardstick of offense seriousness, the vertical "Offense Level" axis of the sentencing grid, has forty-three levels, while the horizontal "Criminal History" axis has only six. Because the sentencing range increases by equal increments along either axis, offense level customarily has a far greater effect on sentence than does criminal history.

D. The Federal Sentencing Guidelines and the Economic Offender

1. Sentencing the Economic Criminal: Some History Creating a sentencing scheme for economic criminals prosecuted in federal courts presents greater difficulties than assigning sentences to those who commit crimes against persons. The first of these difficulties might be termed "historical." The common law, and more particularly the body of Anglo-American statutory law that evolved from it, created a plethora of legal categories for crimes against persons that assigned offense seriousness rankings based primarily on only two of

the factors previously discussed: the culpable mental state of the defendant and the degree of harm caused to the victim. For example, if A strikes B, the statutory law of most states stands ready to receive A into one of nine or more pre-defined categories ranging from capital murder to misdemeanor assault. If B dies from the blow, there are as many as six kinds of homicide, distinguished from each other primarily by different culpable mental states.49 If B lives, there will generally be at least three types of assault charges available, usually differentiated by the degree of physical harm caused (or sometimes merely risked) to the victim and by the type of weapon employed.50

By contrast, in early law there were several different crimes of dishonest acquisition, but little or no difference in degree between them. Many historians believe that at earliest common law, all larcenies (the only property crime recognized for many years in England) were felonies and punishable by death.51 By 1275, larceny was divided into grand and petit larceny depending on the value of the goods stolen; both crimes were felonies, but only the former was punished with death.52 In the 1700s, Parliament enacted statutes creating the crimes of false pretenses53 and embezzlement,54 both of which were "misdemeanors" though punishable by penalties we would now consider appropriate to "felonies."55 Modern codes generally consolidate the various types of property crimes into the single crime of "theft," each of the old familiar categories becoming now but a different method of committing the same offense.56 There are generally only two or three degrees of theft, with the primary distinction between the degrees being the value of the thing stolen.57

In addition, modern state penal codes include crimes such as robbery, burglary, or extortion that customarily involve stealing in some form.58 Statutes often divide these crimes into degrees, but the focus of the offenses is less on economic harm than on invasions of other interests59-the sanctity of the home, the risk of physical violence, the threat to people, property, or reputation implicit in extortion. Accordingly, the factors establishing the relative seriousness of the statutory degrees of burglary, robbery, and extortion are almost exclusively noneconomic. The difference between simple and aggravated robbery is the presence or absence of a weapon.so The difference between first and second degree burglary is most often the presence of a weapon or the commission of an assault during the crime.gl

Notably absent from the traditional ranking calculus of economic crimes is any consideration of mental state or of the nature and quality of the acts which make up the crime. Of course, imposition of liability requires proof of both a culpable mental state and some voluntary act. However, the mental state necessary to almost all simple theft-type crimes is some variant of an intent to steal, defraud, or otherwise deprive the owner of the use or benefit of his property.62 No statutes distinguish between more and less reprehensible degrees of larcenous intentionality. Similarly, theft-type statutes prohibit a host of means by which victims may be relieved of their property, but method is not a factor in ranking such crimes.63

This pattern of historical development has produced a variety of well-developed, long-recognized statutory guideposts for distinguishing between more and less serious crimes against persons, but only one recognized, commonly codified determinant of the degree of seriousness of economic crimes-the value of the thing stolen. Why has this simple, and seemingly simplistic, approach to categorizing economic crimes persisted? The probable answer is that it suited the theft cases that predominated in the developing law of England before very recent times, and that continue to predominate in most American state courts. As George Fletcher has observed, early theft law, both in England and on the European continent, concerned itself largely with cases of "manifest thievery," that is, cases that look and feel like the paradigm of a thief seizing one's goods by stealth and carrying them away.64 Despite being the source of endless headaches to generations of judges, lawyers, and law students, the common law and early statutory crimes like larceny by trick, embezzlement, and false pretenses that developed to fill perceived gaps in the early law of larceny65 were nonetheless directed at conduct instinctively

identifiable as stealing. Even today, the vast majority of economic crimes adjudicated in state courts remain very close to the classic model of manifest thievery or its early offshoots: The defendant stole a car, picked a pocket, tapped a till, wrote a dud check, or doctored the books, and it is easy to figure out what was stolen, from whom, and how much it was worth.ss The defendant's methods were unremarkable, and his state of mind was patent and effectively indistinguishable from that of virtually all other such offenders. In these simple circumstances, the value of the thing taken is not a bad proxy for the extent of the injury caused or threatened by the defendant's behavior, and is thus a good indicator of the relative seriousness of the crime.

By contrast, there are hundreds of federal economic crimes. Of the roughly 970 criminal statutes listed in the Statutory Index to the Federal Sentencing Guidelines,67 some 250 of them are sentenced using either the theft guideline, section 2B1.1, or the fraud guideline, section 2F1.1.68 This total does not include the federal versions of crimes such as burglary,19 robbery,70 extortion,7l blackmail,72 bribery,73 or criminal copyright infringement,74 all of which are also crimes of dishonest acquisition.75

Federal economic crimes also cover an immense range of disparate conduct and implicate an array of interests beyond those of easily identifiable victims in readily quantifiable amounts of money, goods, or services. Federal criminal laws protect the integrity of commodities markets76 and prohibit the sale of unregistered securities through the mail.77 They punish removal, disturbance, or destruction of the "graves, relics, or other evidences of an ancient civilization,"7s and the removal of documents relating to claims against the United States.79 They prohibit counterfeiting United States currency,s* the obligations of foreign countries,81 and the papers of ships.82 More familiarly, federal law punishes theft and embezzlement from federally insured banks,? and criminalizes every "scheme or artifice to defraud" carried out by means of either the U.S. Mail8 or interstate wire communications,85 or directed at any health care benefit program.?

Moreover, penalty levels for federal economic crimes vary widely and conform to no discernible pattern. The maximum penalties for federal economic crimes range from misdemeanor levels of a year or less,sT to five years per count of conviction for wire and mail fraud,ss to thirty years for bank fraud,8 to life imprisonment for conducting a "continuing financial crimes enterprise."0 These penalties are not tied to an overall ranking scheme, such as those nearly universal in state systems, where the legislature creates a limited set of offense categories (e.g., "Class 1," "Class 2," "Class 3") and assigns every crime in the criminal code to one of the categories.91 Such a scheme embraces all types of crime and incorporates legislative judgments about the relative seriousness of different offenses. By comparison, penalty ranges for federal economic offenses seem almost whimsical, owing more to the political enthusiasms of the moment they were enacted than to any reasoned effort to compare the relative seriousness of different crimes.92

The void created by the absence of meaningful congressional guidance on questions of relative offense seriousness is enlarged by yet another condition common in federal economic crime prosecutions. Statutory structures, state and federal, for crimes against persons have a marked cabining effect on sentences largely because a conviction for such offenses is likely to be of a single count-one murder, one assault, one rape, one robbery. Multiple counts of conviction for crimes against persons have a tendency to merge for sentencing purposes; when they do not, distinctly different harms are likely being punished-two dead victims if there are two counts of homicide, two robbed stores if there are two counts of robbery. The relationship between the number of counts of conviction and the number of discretely identifiable harms is much more blurred in federal white collar cases. The most notable examples are wire and mail fraud, offenses in which every separate mailing or interstate wire communication in furtherance of the criminal scheme is a separately indictable and punishable offense.9

By way of illustration, if a state legislature decides that the appropriate penalty range for one second degree murder is twelve to twenty-four years, the sentencing judge will probably be precluded from sentencing the defendant to more than twenty-four years (a penalty range the legislature thought it was reserving for first degree murder). The judge will be equally constrained from sentencing the defendant to less than twelve years, a range the legislature thought appropriate for various forms of manslaughter.? In contrast, until the advent of the Federal Sentencing Guidelines, the length of possible sentence faced by a federal white collar offender ran from a minimum of probation to a maximum term of imprisonment calculated by multiplying the number of counts of conviction times the maximum statutory sentence for each such count.95 Thus, legislative judgment about offense seriousness implicit in the decision to set five years as the maximum sentence for one count of a crime such as wire fraud disintegrated in the face of untrammeled prosecutorial discretion to charge one count or twenty arising from the same scheme, and the equally unlimited power of a judge to sentence anywhere within a legally permissible range of zero to 100 years.

Thus, when the United States Sentencing Commission set out to create guidelines for sentencing economic criminals, it faced an array of difficulties greater than that presented by virtually any other category of offender.

2. The Guidelines' Approach to Economic Crimes

The issues addressed by the Guidelines fall broadly into two categories: first, issues common to all offenders regardless of their particular offense; and second, issues specific to particular offenses. Into the first category fall treatment of criminal history,9 the multiple count rules,97 relevant conduct,os adjustments for the defendant's roles and for vulnerable victims,loo and the virtual exclusion of the defendant's personal circumstances and characteristics from the calculation of guideline range.lol The second category contains all the rules concerning the offenses for which the defendant is being sentenced. These are found in Chapter Two, "Offense Conduct."102

The Commission's approach to drafting Chapter Two guidelines was empirical and historical, rather than normative or philosophical. That is, with a few notable exceptions, the Commissioners did not attempt to determine what the penalty for any given offense should be; rather, they set out to reproduce the sentencing patterns in existence before the Guidelines.l03 The Commission studied a sample of 10,000 past cases in order to identify the characteristics of both offenders and offenses that judges had historically deemed important in making sentencing choices.l04 In effect, the Commission attempted to discover and codify the federal common law of sentencing.

In the case of economic crimes, the Commission adhered to its historical approach in some respects, but diverged from it in others On the one hand, the Commission attempted to ascertain the factors that had historically been important in sentencing economic crimes, and to incorporate their findings in the Chapter Two offense conduct guidelines. On the other hand, the Commission consciously chose to raise sentencing levels for crimes against property over preGuidelines levels.los The commissioners were plainly concerned that probationary sentences had been too common in-economic crimes,los and were convinced that the Guidelines' objectives would be better served by the imposition of "short but certain terms of confinement for many white collar offenders."107

Although the Commission was correct to raise sentences for economic crimes above their de minimis historical levels,los its effort to identify sentencing factors federal judges had in the past found determinative for economic crimes produced rather lean results.

Indeed, the Commission mentions only two such factors in the commentary to the guidelines governing theft and fraud: the amount of loss, and the amount and sophistication of planning activity involved in the crime.los

For the purpose of drafting guidelines, the Sentencing Commission divided federal economic crimes into two basic types:

(1) crimes involving "the most basic forms of property offenses-theft, embezzlement, transactions in stolen goods, and simple property damage or destruction,"llo sentenced under section 2B1.1;lll and

(2) fraud crimes, sentenced under section 2F1.112 Then, having gone to the trouble of creating this "great gulf fixed"13 between theft on the one hand and fraud on the other, the Commission drafted two virtually identical guidelines. (The theft guideline, section 2B1.1 is reproduced as Table 1. The fraud guideline appears as Table 2).

The term "loss" is not defined in the text of the Guidelines.lle The primary definition appears in Application Note 2 to the theft guideline. The heart of the definition is this: "'Loss' means the value of the property taken, damaged or destroyed."117 The fraud guideline explicitly incorporates this definition,lls and Application Note 7 to section 2F1.1 goes on to state: "Frequently, loss in a fraud case will be the same as in a theft case."lls This language raises but does not answer the question of when loss in theft cases will be the same as loss in fraud cases.

(Table Omitted)

Captioned as: TABLE 1114

(Table Omitted)

Captioned as: TABLE 2115

The fraud commentary sets out a number of special rules for particular cases, such as procurement fraud,l20 diversion of government program benefits,12 and Davis-Bacon Act cases.l22 Under both the theft and fraud guidelines, "the loss need not be determined with precision. The court need only make a reasonable estimate of the loss, given the available information."123 Finally, the general rule for both theft and fraud cases is said to be that courts should use the greater of actual or intended loss, if the intended loss is different from the actual loss and can be determined.12

A court would sentence a defendant convicted of a theft-like crime as follows. The base offense level for all theft crimes is 4.125 If the defendant stole $ 1,000,000, the court would consider the "specific offense characteristic" of an amount of loss between $ 800,000 and $ 1,500,000, and would add another 13 levels.lzs If the defendant took the money from his victim's person, the court would add yet another 2 offense levels.l27 Thus, a million-dollar purse snatch or jewelry grab would yield a total Chapter Two offense level of 19 (4+13+2=19).

If the defendant defrauded the same victim of $ 1,000,000, his base offense level would be 6,lzs and the court would add 11 levels for a loss of between $ 800,000 and $ 1,500,000.129 If the crime involved "more than minimal planning," the court would add another 2 offense levels. A million-dollar fraud would therefore also produce a total offense level of 19 (6+11+2=19).

This simple comparison should not be taken to suggest that the theft and fraud guidelines will always produce identical offense levels for crimes with the same loss amount.130 However, three points should be apparent. First, the theft and fraud guidelines are virtually, though not absolutely, identical. Second, despite

identifying the amount and sophistication of planning activity as one of the two traditionally determinative sentencing factors in economic crimes, the Commission's only effort to account for this factor is the two-level increase for "more than minimal planning."131 By contrast, the loss amount can change the final offense level by 18 levels in fraud cases and 20 levels in theft cases.132 Third, and consequently, the operational core of both guidelines is the loss table; more than any other factor, loss will drive the sentencing range under either guideline.

Having sketched the basic structure of the Guidelines' provisions for sentencing economic criminals, this Article now turns to a critique of that structure and offers a series of concrete proposals for revision.

III. AN ANALYSIS OF THE ECONOMIC CRIME GUIDELINES AND A BLUEPRINT FOR REFORM

A. The TheR and Fraud Guidelines Should Be Consolidated There is no good reason to have separate guidelines for theft and fraud. At least three compelling reasons support consolidating the fraud and theft guidelines: (1) The distinction between theft and fraud is illusory; (2) application of either guideline to the same facts produces nearly identical sentences; and (3) separate guidelines produce needless confusion. I will examine each of these contentions in turn.

1. The Distinction Between Theft and Fraud Is Illusory

The Commission's reasons for dividing economic offenses into theft-like crimes and fraud-like crimes remain obscure. Whatever the reasons, the distinction is both doctrinally and practically meaningless. Although not all theft crimes are frauds, virtually every fraud could be charged as one of the common law property crimes, or under one of the modern consolidated theft statutes. Consider, for example, a variation on the classic illustration of the difference between the traditional property crimes of larceny, larceny by trick, false pretenses, and embezzlement:

V owns four horses. A sneaks into the corral where the horses are kept and rides away on one of the horses. B approaches V and asks to rent a horse, promising to pay $ 10 and to return the horse tomorrow. B has no intention of keeping either promise and rides off with the horse, never to be seen again. C comes to V and says that she is acting on behalf of a charitable organization that runs a riding stable for mentally handicapped children and asks V to donate a horse. V does so and transfers title to a horse to C. In fact, C is a crook who takes the horse around the corner and sells it for a profit.

D rents V's last horse, fully intending to return it as promised, but the next morning decides otherwise, keeps the horse for himself, and leaves V a message falsely stating that he, too, has donated a horse to the children's stable. In this scenario, A has committed larceny,l33 B larceny by trick,'34 C false pretenses,15 and D embezzlement.l3s Yet, if B, C, and D happened to make their false statements on the telephone across a state line, they could just as easily be charged under federal law with wire fraud.l37 In each case their conduct could be characterized as a "scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses."38

Indeed, "fraud," meaning some false statement intended to induce the victim to part quietly with either possession or title to property, is an element of both larceny by trick and false pretenses. Similarly, even though fraud is not an element of embezzlement,139 it is usually present at some point in most embezzlement cases.l4

The convergence of theft and fraud crimes is even more pronounced in the codes of states that followed the Model Penal Code and consolidated previously distinct property crimes under the single rubric of "theft."141 Such statutes customarily define theft in a way that reaches most, if not all, commonly encountered frauds. The reach of these statutes is so broad that some states feel no need for separate fraud laws.l42

The overlap between theft and fraud is not confined to state criminal law. Where many states have consolidated all property offenses, including those involving fraud, into unitary theft statutes,l43 federal law abounds with instances in which the same course of thievery is chargeable under multiple statutes, some of which are called "frauds" and some of which appear to be traditional theft-like offenses. For example, if an employee of a federally insured bank steals some of the bank's money, he can be charged under 18 U.S.C.

656 with theft, embezzlement, or misapplication by a bank officer or employee. If in carrying out the defalcation he uses means much more complex than lifting cash out of a drawer and walking out the back door, he can also be charged with bank fraud under 18 U.S.C.

1344. If he then employs the U.S. Mail or an interstate wire communication, he might also be charged with mail fraud, 18 U.S.C. 1341, or with wire fraud, 18 U.S.C. 1343.

In sum, the Guidelines' division of property offenses into theft and fraud crimes is analytically meaningless because it rests on a distinction that has no sound basis in either common or statutory criminal law, and is valueless as a practical matter because identical facts can so often be charged as either a "theft" or a "fraud."

2. Application of Either Guideline to the Same Facts Produces Nearly

Identical Sentences

Even if it were possible to draw a meaningful distinction between theft and fraud, it would be useful to do so only if the objective were to generate different sentencing outcomes for the two categories of cases. However, as noted above,TM the sentencing range under both guidelines is driven almost entirely by loss amount. Because loss apparently means the same thing in both guidelines (the fraud guideline adopts the theft guideline's definition of lossl45), application of either section 2B1.1 or section 2F1.1 to the same set of facts usually produces either identical sentencing ranges, or a pair of ranges so close that the top of one will approach or overlap the bottom of the other.146 Thus, in the overwhelming majority of cases, the existence of separate fraud and theft guidelines is pointless duplication.

3. Separate Theft and Fraud Guidelines Create Needless Confusion

In a guidelines scheme often criticized for its length and complexity, the mere fact that two guidelines are duplicative should be a sufficient argument for consolidation.l47 An even more compelling argument arises from the fact that ingenious judges and lawyers have sought to impute meaning into the theft/fraud distinction, and in doing so have created only confusion.

A series of cases from the Third Circuit graphically illustrates the potential for such difficulties. In United States v. Kopp, the defendant obtained a $ 13.75 million loan by fraud.l48 He argued at sentencing that the loss was zero because the bank liquidated the collateral for more than the loan amount. The Third Circuit addressed the problem by attempting to reconcile the differing approaches to theft and fraud cases suggested by the text and commentary of section 2B1.1 and section 2F1.1. The court noted that "calculations under the two guidelines are essentially consistent," but that slight differences led them to "decline to impose an identical analysis for theft and fraud crimes in all cases."149 The court concluded, "In both theft and fraud cases, the guideline loss' turns out to be the higher of the actual loss and the intended loss."lso Application Note 7 to section 2F1.1

specifies the intended loss measurement as to fraud; no such specification exists in the theft guideline, section 2B1.1, or in its accompanying commentary.lsl The Third Circuit nonetheless concluded that intended loss, if higher than actual loss, was the proper measure in theft cases. In its view,

(I)n a theft case, the thief in.tends to steal whatever he or she takes; the amount taken is the loss the defendant intended to inflict... In a theft case, unlike a fraud case, the amount taken (the intended loss) is always as high or higher than the amount the victim actually lost (which may be reduced due to fortuitous recovery of the stolen property).152

Even at this point in its analysis, the Third Circuit had strayed onto shaky ground. First, the court erroneously assumed that there was a clear demarcation in federal law between "theft" and "fraud" crimes.l53 Further, the court implicitly assumed that the culpable mental state in theft-like crimes sentenced under section 2Bl.1 is "intent to steal," which the court seemed to equate with intent to permanently deprive. However, the required culpable mental state in embezzlement, misapplication of funds, and other similar crimes is merely an intent to convert the property of another to one's own use or benefit, perhaps for a short period.l54 The Kopp court recognized this difficulty, suggesting in a footnote that "embezzlement, unlike ordinary theft or fraud, involves not only a taking but also an action akin to a breach of a fiduciary duty, which might justify always using the amount taken as 'loss.' "155

The Third Circuit explored the section 2Bl.1/section 2Fl.1 distinction in detail a year after Kopp in United States v. Badaracco.l5 The defendant, a bank insider, had interests in his family's electrical contracting businesses. He coerced a developer/borrower into dealing with the family contractors at prices higher than competing bidders. The defendant banker was convicted of bank fraud for misrepresenting to the bank his relationship with the family companies. The court found that the "loss" was the gross amount of three contracts awarded to the family electrical contractors with no offset either for the market price at which the contracts could have been let or for the value of work actually performed by the family contractors.

The Third Circuit distinguished these facts from fraud, where the measure of loss is the actual economic harm caused or intended. Citing Kopp,'s7 the court analogized the case of Badaracco to embezzlement because it involved a breach of trust; hence, said the court, the proper measure of loss was "gross" gain to the defendant, with no deduction for benefits conferred on the victim after the "taking."158 In both Kopp and Badaracco, the version of Application Note 8 to section 2F1.1 in effect at sentencing referred to "offender's gross gain" as an alternate measure of "loss." In both cases, the court noted that the language was amended after sentencing, but before decision on appeal, to omit the word "gross."159 In neither case did the court think the amendment affected the outcome.

Three years after Badaracco, the Third Circuit decided United States v. Coyle.lso The defendant was a health care plan administrator for Hospital Corporation of American ("HCA") who overstated administrative costs and provider charges in order to justify a retention of larger premiums. At sentencing, the district court based "loss" on the gross economic gain to HCA. The defendant argued on appeal that this measure of gain overstated the victim's losses. The Third Circuit avoided the issue of the victim's real economic loss by arguing that "this scheme ha(s) a strong resemblance to embezzlement" and therefore that "gross gain" (i.e., what was "taken" with no deductions for any benefit conferred in return) was an appropriate measure of loss.161 Coyle appeared to confirm that the Third Circuit's use of "gross gain" to measure loss in embezzlement-like cases would survive the 1991 amendment to Application Note 8 to section 2F1.1, which changed "offender's gross gain" to "offender's gain."162

This reading of Coyle was cast into question by the Third Circuit's 1995 decision in United States v. Dickler.l63 There the court "explained" its previous holdings by observing that where fraud is "similar to theft," in that the defendant "takes" something from the victim without giving anything in return, the gross gain measurement is appropriate.l34 By contrast, where "value flows in both directions," then the value flowing to

the victim should be subtracted.les This "explanation" of the earlier holdings amounts to a finding that "loss" equals net economic loss. It ignores the facts of Badaracco and Coyle, in which the loss attributed by the court clearly exceeded the actual economic loss to the victims. In both cases, the presence of a breach of trust was made to override considerations of economics.

The 1996 case of United States v. Maurello rendered the state of the law in the Third Circuit still more uncertain.lss The defendant in Maurello was a disbarred lawyer convicted of mail fraud for practicing law without a license. The district court, noting the defendant's breach of fiduciary duty, calculated the amount of loss as the total amount of fees charged to unsuspecting clients.l67 The court of appeals reversed, holding that the value of services successfully rendered to the clients should be deducted from the total amount of the fees.lss In the course of reaching this result, the court cast the entire Kopp-Badaracco-Coyle line of analysis into doubt. It attempted to distinguish Badaracco by arguing that the crime in that case was more like an embezzlement than the offense in Maurello. Recall that Badaracco was a bank officer who was found guilty of coercing certain borrowers of the bank to use contracting companies in which Badaracco had an interest, and misrepresenting to the bank his connection to those contractors. The Third Circuit contended that because Maurello was convicted of mail fraud for inducing his clients to part with fees based on lies about his licensure as an attorney, and therefore "did not fraudulently convert money over which he had possession or control" his crime was less like embezzlement than Badaracco's conduct.lss The distinction is not compelling.l70 If the comparison illustrates anything, it is the potential for confusion that flows from the existence of two guidelines which differ only slightly yet cover overlapping groups of offenses.171

B. Retaining the "Loss" Concept, While Identifying and Accounting for Other Sentencing Considerations "Loss" Does Not Measure Well

A consolidated economic crimes guideline should retain as a central component a measurement akin to the current "loss" concept. All else being equal, stealing more is worse than stealing less. This intuitive judgment has been at work among Anglo-American lawmakers since the division of larceny into grand and petit varieties in 1275.172 The basic principle remains sound, but its incorporation into the Guidelines through the concept of "loss" in section 2B1.1 and section 2F1.1 has proven problematic. As currently defined, loss functions as an imperfect proxy for too many sentencing factors. The first of these is mental state.

1. Accounting for Differences in Economic Criminals' Mental State

As noted above, offense seriousness rankings are the product of the interaction among the fundamental components of criminal liability-act, mental state, cause, and harm.l73 "Loss" is plainly intended to measure harm, but under the present regime it also serves by default as a gauge of the defendant's guilty mind. Recall that the mental element of virtually all economic crimes is some variant of an intent to steal, defraud, or otherwise deprive the victim of the benefit of his property. Thus, under statutory law, all convicted thieves, embezzlers, and con artists are effectively indistinguishable as regards mens rea. Nonetheless, we instinctively recognize more and less blameworthy conditions of mind in economic criminals, just as we do with murderers. The challenge for a drafter of sentencing guidelines is to identify those factors relating to mental state that should matter in the imposition of economic crime sentences, and then to account for them in the guideline scheme.

The persistent historical impulse to rank property crimes by the value of property stolen surely rests on a judgment about mental state, as well as on the more obvious assessment that size of loss relates to harm. Stealing more is worse than stealing less because one who desires to inflict a large harm is customarily thought to have a more reprehensible condition of mind than one who desires to inflict a smaller harm. To this extent, "loss" is not a bad proxy for mental state.

Nonetheless, our thinking about the relative blameworthiness of thieves is more complex than a measurement of the amount of the loot. The problem is to tease out the nonmonetary considerations. The authors of a systematic study of federal sentencing practices for white-collar offenders conducted in 1988, before the Guidelines, surveyed federal judges about the sentences they gave economic criminals and the reasons for giving them.l74 Although not rigorously empirical, the study confirms many common sense expectations about sentencing practices. The study results confirm the original Sentencing Commission's findingl76 that sentencing judges consider important the amount of planning and the complexity of the criminal scheme.l76 This conclusion is unsurprising. In all types of crime, a defendant who plots, plans, and schemes to achieve an evil end is thought more culpable than one who causes the same harm on impulse. The study also identified other factors that entered into judges' sentencing decisions, such as leadership role within the criminal undertaking,l77 whether the defendant betrayed a position of trust,lTB indications of genuine contrition,179 and cooperation with authorities.l80

All of these considerations relate to mental state, and the current Guidelines contain provisions dealing with all of them. The twolevel upward adjustment for "more than minimal planning" included in both the theft and fraud guidelines accounts for complexity of scheme and extent of planning activity.lal The defendant's role, as leader or follower, can generate upward or downward adjustments of up to four offense levels.182 A two-level upward adjustment penalizes abuse of a position of trust.l8 Contrition is at least the ostensible subject of the "acceptance of responsibility" guideline.18 And defendants who provide "substantial assistance" to the government in investigating and prosecuting others receive the biggest potential sentencing rewards.l85

With one notable exception-the "more than minimal planning" adjustment-these offense level adjustments probably do about as good a job as can be done in a determinate guidelines system of accounting for identifiable factors in assessing a financial felon's state of mind. Nonetheless, the failure of "more than minimal planning* is

significant and ought to be remedied. Because courts have applied the language of the provision quite literally, nearly every convicted defendant whose crime was not one of pure impulse receives the upward adjustment. More than eighty percent of all defendants sentenced under the fraud guideline and nearly sixty percent of those sentenced under the theft guideline are assessed the two additional levels for more than minimal planning.lss Hence, the theft and fraud guidelines do not winnow out the minority of really sophisticated schemers from the mass of ordinary thieves; rather, they separate the minority of simpleminded crooks from the vast majority of felons with even modest claims to cleverness. Moreover, by providing only a uniform two-level adjustment to all qualifying defendants, the guidelines prevent sentencing judges from making distinctions among complex, moderately complex, and truly inspired criminal schemes.

The Commission is presently considering abolishing the "more than minimal planning" adjustment, building the two-level increase into the sentencing table, and adding a section that adjusts for complex planning by analogy to the "sophisticated means" enhancement now available in tax cases under section 2Tl.l(bX2).l87 The Commission should adopt this proposal, with one addition. It should include a section permitting a two-level downward adjustment for defendants whose crimes did not involve even minimal planning.

Having both an upward and a downward adjustment for sophistication of scheme would create a three-tier system with the simple, impulsive crimes at the bottom, the offenses of average complexity in the middle, and truly sophisticated offenses at the top. Under such a scheme, sentences would vary by up to four offense levels based on degree of planning activity. Such an arrangement would yield both structure and some flexibility for sentencing judges.Iss

2. Accounting for Noneconomic Harms

Although pecuniary loss may seem a somewhat unnatural proxy measurement of mental state, it is the universally accepted measurement of harm in economic crimes. However, even this more intuitively obvious equivalency is not without problems. The difficulties are illustrated by comparison with the other important proxy value in the Guidelines, the weight of narcotics.[189] Leaving to one side problems with comparisons of gross weight versus dosage units and similar technical matters,[19] narcotics weight is a decent proxy for social harm. Ingestion of banned substances by end users creates direct psychological and physical effects and risks of a host of collateral harms, such as job loss, family breakup, addicted infants, increased crime by addicts to support their habits, etc. One can argue about the degree to which drugs are actually responsible for these harms (and whether incarceration effectively reduces them). However, whatever harms are in truth attributable to the narcotics trade are pretty directly proportional to the amount sold.

By contrast, both the type and degree of harm caused by a dollar's worth of economic crime will vary from crime to crime. A dollar stolen from a millionaire means less than a dollar stolen from a pauper. Stealing from Donald Trump is different than stealing from Mother Teresa. Ten thousand dollars lost from a parent's savings on the eve of a child's entry into college has a vastly different significance than the same amount lost while there is still time to plan for that child's education. Stealing a fifty dollar coffeemaker from an airplane is different than stealing a fifty dollar component of the landing gear.

The Guidelines should identify regularly occurring non-monetary harms resulting from economic crimes and account for them outside of the "loss" proxy.

a. Number of Victims

The Guidelines presently take inadequate account of cases involving multiple victims. When a defendant steals from several people, he inflicts losses on a wider segment of the community than if he steals from only one person. The fact that a defendant stole from several people is unquestionably relevant to the amount of planning required and thus to mental state, even where the defendant merely committed the same simple crime against a sequence of new victims. However, the presence of multiple victims is also, and more fundamentally, a factor related to harm.

At present, the Guidelines consider the number of victims only as an alternative means of qualifying for the two-level "more than minimal planning" adjustment.[191] The consolidated economic crimes guideline proposed here provides a separate enhancement that increases offense level with the number of victims.[192] The number of victims used in the proposed guideline (2-4, 5-20, 21+) is concededly arbitrary. The Commission should research the distribution of low, medium, and high numbers of victims among existing cases and make appropriate adjustments.

b. Significant Financial Hardship

The Guidelines already account in section 3A1.1 for situations in which a defendant preys upon a victim who is peculiarly susceptible to the crime at issue.[193] However, the Guidelines provide no adjustment for unusually severe effects of crime. Application Note 10(f) does suggest an upward departure where the offense "involved the knowing endangerment of the solvency of one or more victims."[194] This seems rather anemic. "Endangerment of solvency" is a phrase both too vague and too restrictive. On the one hand, it is unclear when a victim becomes insolvent (must he file for bankruptcy protection?), and even more unclear when he is in danger of becoming so.

On the other hand, insolvency, however defined, is only one of the unusually severe effects of economic crime that ought to affect sentencing outcomes. When a defendant causes a victim to lose a home, a job, a

pension, health benefits, or other components of financial security, the court should account for the nature of those losses as well as their quantity.

As a solution to this problem, the Commission should adopt a two-level upward adjustment for cases in which a defendant causes "significant financial hardship" to one or more victims. A proposed definition of "significant financial hardship" appears as Application Note 5 to section 2Z1.1 in the Proposed Consolidated Economic

Crimes Guideline (Appendix A).

IV. "Loss": WHAT SHOULD IT MEAN, AND HOW SHOULD

IT BE MEASURED?

A. The Problem of Inclusion: Redefining Loss in Terms of Cause-in-Fact and Foreseeability

Although *loss" serves other functions as well, it is first and foremost a measurement of economic harm. Any attempt to rank economic crimes using the concept of loss faces two basic definitional problems: the problem of inclusion, that is, deciding which harms to include and which to exclude from the ambit of loss and the problem of measurement, that is, creating rules that assist courts in calculating the monetary value of the included categories of economic harm.

The Guidelines are singularly uninformative on the subject of which pecuniary harms should be included in "loss." They leave two fundamental questions largely unanswered. First, who are the victims whose losses are to be counted? Second, which pecuniary harms suffered by those victims are to be included in the loss calculation? As we will see, fundamental principles of criminal liability regarding fault and causation can resolve these questions. But before proposing a solution, we should examine the difficulties the Commission and the courts have encountered in addressing causation and the problem of inclusion.

At the root of the problem of inclusion is the Guidelines' attempt to embrace two distinct, and inconsistent, conceptions of loss. The theft guideline sets forth the basic definition of loss-"the value of the property taken, damaged, or destroyed"[196]-which was plainly drafted with the model of simple common law property crimes in mind. The word "taken" is close to a term of art, denoting to any Anglo-American lawyer the "taking" element of common law larceny, with its insistence on a transfer of possession of moveable personalty.,* Read on its face, therefore, the basic definition of loss apparently includes only what might be termed the corpus delicti of basic property crimes, the "thing of value" of which the victim was deprived. Because the fraud guideline adopts this strikingly limited definition virtually verbatim,[197] it has become the primary measurement of offense seriousness for all federal economic crimes.

Grafting larceny terminology onto the sentencing procedures of every economic crime has created problems beyond the inevitable definitional confusion.[198] The more fundamental difficulty is that a very narrow definition of loss is at odds with a conception of loss as a broad proxy measurement of offense seriousness in general, and of harm in particular. This basic conceptual conflict is patent both in the Guidelines themselves and in the cases construing them.

1. Who is the "Victim"?

The Guidelines blithely refer to "the victim," yet nowhere do they define the term.[199] This surprising omission is surely an incidental consequence of the Commission's choice to define "loss" with the model of simple common law or statutory theft crimes in mind. In such cases, the identity of the victim is usually obvious

and undisputed, both because the transactions are simple, and because the victim is usually identified in the indictment or information.

Sentencing federal economic crimes differs from sentencing simple property crimes in two critical respects. First, the nature of federal economic offenses is such that, even as to the counts of conviction, it is often unclear who ultimately suffered financial harm as a result of the defendant's conduct, and even less clear whether those who were harmed in fact ought to be considered "victims" in law. Second, because the Guidelines are a modified real offense system, the class of victims is not limited to those who were injured by the conduct covered by the counts of conviction, but extends to all the victims of a defendant's "relevant conduct."200 We will consider these problems seriatim.

a. Who Is the Victim of the Offense of Conviction?

Should the Guidelines count the losses only of those with whom a defendant dealt directly, or should loss measure financial harm caused by the defendant's crime but suffered by persons or entities with whom the defendant did not have direct dealings? The Ninth Circuit grappled with this question in United States v. Harper.201 The defendant obtained possession of heavily encumbered residences for no money by promising the owners that he would assume their mortgages. In fact, the defendant neither assumed the mortgages nor made mortgage payments. Instead, he rented out the premises to tenants and kept the rent. Upon discovery of the scheme, the banks foreclosed on the properties. The defendant pled guilty to mail fraud, equity skimming, and conspiracy.202 The district court decided that the "loss" was the fair market value of the houses plus the rents paid to the defendant by the tenants.203 The Ninth Circuit reversed, apparently because the owner-occupants did not control equity equal to the fair market value and thus were not deprived of that amount,204 and because the banks holding the mortgages did not lose their right to foreclose and thus were not deprived of the entire market value of the property.205

Despite rejecting the district court's loss calculation, the Ninth Circuit did not actually decide what the proper measure of loss should have been. The court discussed the possibility that the defendant caused financial injury to the homeowners, the renters, the banks, and the federal treasury. The homeowners suffered damage to their credit ratings and perhaps deficiency judgments resulting from the foreclosures. But since these particular homeowners were on the verge of foreclosure anyway, the portion of such losses attributable to the defendant's scheme was likely to have been small.zos The renters obtained what they paid for, at least until the fraud was discovered and they were evicted.207 The real losers were the banks and, potentially, the U.S. Treasury. The banks, though secured to the extent of the foreclosure value of the homes, lost any uncollectible deficiency, as well as mortgage payments not made between the transfer of possession from the owners to the defendant and discovery of the fraud. The Treasury lost money to the degree the government was obliged to make good on loan guarantees for homeowners who would not have defaulted but for the defendant's conduct.

The defect in the Ninth Circuit's Harper opinion is that it never squarely addressed the question of which of these losers were "victims" whose losses should count under the Guidelines. Because the defendant dealt directly with, made misrepresentations directly to, and obtained something of value directly from both the homeowners and the renters, it is fairly obvious that both these groups should be considered victims for the purpose of sentencing. However, the banks and the Treasury present more difficult problems. The defendant neither dealt with nor deceived the banks or the government, nor did he receive anything of value from either. One possible argument for considering them victims is that the defendant pleaded guilty to violating the equity skimming statute, which is clearly designed to protect the interests of lenders participating in federally guaranteed loan programs, and of the government itself as guarantor.28 Thus, it might be argued that the banks

and the government should be victims in this case because Congress passed the statute of conviction for the purpose of protecting banks and the government from exactly the kind of loss inflicted by this defendant.

Although congressional intent is certainly relevant to a determination of the proper scope of "loss" (including the identity of the "victims")29 exclusive reliance on that factor is problematic, as can be illustrated by assuming slight modifications of the events in Harper.

If, based on the same facts, Harper had been charged only with mail fraud and not with equity skimming, congressional intent to protect either banks or the U.S. Treasury would not be relevant, and thus pecuniary harms to the banks and the government would not be counted as loss, despite the defendant's identical conduct.210 Such a result would be contrary to the "modified real offense" design of the Guidelines which aims to sentence on the basis of the defendant's actual conduct and resultant harms regardless of how the case is charged or pled.211

The most coherent explanation for the Harper court's implicit acceptance of homeowners, renters, banks, and the government as legitimate victims for purposes of determining loss is that all four groups suffered economic losses which were caused in fact by the defendant's criminal conduct. On the facts of Harper, the inclusion of all four groups seems unexceptional. Other cases raise more acutely the issue of the necessary causal connection between the defendant's wrong and the harms of putative victims. For example, the Third Circuit raised, but did not resolve, this question in United States v. Maurello.212 The court found that the loss caused by Maurello's unlicensed legal practice should be calculated by deducting the value of legal services satisfactorily rendered from the amount of fees charged because clients who received satisfactory legal services had suffered no real harm.213 The government contended that the total fees should nonetheless be counted because that money "was diverted from defendant's legitimate competitors" (i.e., licensed attorneys).214 The court rejected that argument, saying that only loss to the "direct victims of defendant's conduct" would be counted.215 Regrettably, the court neither defined the difference between direct and indirect victims, nor explained why losses to the first but not the second should be counted.zxs

So who is the "victim" of an economic crime? Do the pleadings control the identity of the victim? Is the dominant consideration whether the defendant had direct dealings with the putative victim?

Is legislative intent relevant? Or is victim identity a fluid concept determined by the facts of the case and the nature of the causal connection between a defendant's conduct and a victim's injury? Neither the Guidelines nor the cases construing them offer satisfactory answers to any of these questions.

b. aGain" and the Problem of Identifying the Victim

The term "loss" necessarily connotes a focus on the extent to which the victim (once identified) has been deprived of something. Nonetheless, the fraud guideline permits use of the gain garnered by the defendant as an alternative measure of loss.217 The inclination to use a defendant's gain as the measure of loss often arises when the defendant seems to have gotten more out of his fraudulent behavior than the victims appear to have lost. For example, in a fraudulent loan case where the loan is properly collateralized or the bank has other readily available sources of repayment in the event of default, the defendant may profit considerably from his deception, but the lender may ultimately suffer negligible economic harm. Similarly, in cases of government contract fraud where the defendant secures the contract through misrepresentation but performs all or part of the contract, the loss to the government may be small. Nonetheless, courts and the Commissioners have been reluctant to forego all lossbased enhancement in such cases, though neither group has been very successful in articulating why.

Some courts seem to view gain as a mechanism for penalizing defendants based on the magnitude of the unjustifiable risk they create for their victims, and on the severity of the ultimate harm actually inflicted.218 What has gone largely unrecognized is that "gain" to the defendant seems more attractive as a measure of offense seriousness where the true victim of the defendant's crime may not be the putative victim named in the indictment.219 The Commissioners, however, did recognize this possibility when they amended section 2F1.1,

Application Note 7, to add subsection (d), redefining loss in cases involving the diversion of government program benefits to mean "the value of the benefits diverted from intended recipients or uses."220 In making this change, the Commission recognized that the federal government may suffer no economic loss if, for example, it guarantees a loan or awards a grant to someone not entitled to it,221 but that for each fraudulently obtained grant or loan guarantee some other deserving person may be deprived of a benefit the government had intended to bestow on that person. In effect, Application Note 7(d) simply says that the intended beneficiaries of government programs are "victims" when the defendant's gain was a benefit intended for them.

This approach is markedly inconsistent with the idea expressed by the Third Circuit in United States v. Maurello that loss embraces only economic harm to "direct victims of the defendant's conduct."222 The harm to potential government program beneficiaries treated as victims by Application Note 7(d) could scarcely be more "indirect," and is hard to distinguish from the harm to licensed attorney competitors deprived of legal business by Mr. Maurello. However, Application Note 7(d) makes perfect sense if loss is supposed to include a broad range of economic harms caused by the defendant, including harms to program beneficiaries whose interests the legislature sought to protect in passing the law violated by the defendant. Considered carefully, therefore, many cases that superficially involve the question of gain are really "who's the victim?" problems.

2. Victims, Relevant Conduct, and Causation

Identifying the victims even of the federal economic crimes of which a defendant was convicted can be challenging. An additional layer of complexity arises because the U.S. Sentencing Guidelines are a "modified real offense" system which requires the sentencing court to consider "relevant conduct," a concept that embraces not only a defendant's own conduct charged in the counts of conviction, but also conduct described in dismissed counts or never charged at all, as well as the conduct of the defendant's criminal partners.

a. Defendant's Unconvicted or Uncharged Conduct

The relevant conduct guideline obligates the sentencing court to consider "all harm that resulted from"us the defendant's "acts and omissions that were part of the same course of conduct or common scheme or plan as the offense of conviction."224 The court must thus determine the identities of all those who suffered loss resulting from the defendant's actions during the entire scheme or set of transactions that led to his conviction.

The Tenth Circuit applied this concept in United States v. Sapp22 to find a loan fraud defendant responsible for losses to Lender #1 (not the named victim), who had discounted a loan in response to an uncharged misrepresentation by the defendant that funding could be obtained from Lender #2 (the named victim) if the first lender discounted its loan. The defendant could have been charged with the falsehoods to Lender #1 which, upon conviction, would have been grouped for sentencing purposes with the false statements to Lender #2. The lies to Lender #1 were part of the same scheme as the crime of conviction involving Lender #2, therefore the defendant was held accountable for the total loss he inflicted on both lenders.226

b. Acts of Defendant's Criminal Partners

The relevant conduct guideline also says that sentencing calculations "shall be determined on the basis of . . . all harm that resulted from . . . reasonably foreseeable acts and omissions of others in furtherance of the

jointly undertaken criminal activity."227 As applied to the theft and fraud guidelines, the effect of the relevant conduct rules should be to hold the defendant responsible for all losses to all victims that "resulted from" his own conduct, as well as for the foreseeable losses to the foreseeable victims of his criminal partners.228

However, section 1B1.3 somewhat incongruously imposes a foreseeability limitation on harms caused by a defendant's co-conspirators and co-schemers, but no such limitation on harms that "resulted from" the defendant's own behavior.229 In short, it appears that the relevant conduct guideline contemplates a pure "but for" causal relationship between the defendant's acts and the harms that result. Apparently, section 1B1.3 permits, or perhaps requires, a sentencing judge to count all the victims and all the harms they suffered as a result of defendant's own acts, regardless of how attenuated the causal link between the acts and the harms, and regardless of whether the defendant could have foreseen the existence of such victims or the nature and extent of their injuries.

3. Causation and "Consequential Damages"

The tension between the sweeping language of the relevant conduct guideline and the cramped primary definition of "loss" is patent. Is loss to be a broad measure of "all" economic harm caused by the defendant consonant with the reach of section lB1.3, or a narrow accounting of property "taken" by the defendant? The uncertainty is rendered still more acute by the Guidelines' treatment of "consequential damages." Application Note 7(c) to section 2F1.1 states: "In contrast to other types of cases, loss in a procurement fraud or product substitution case includes not only direct damages, but also consequential damages that were reasonably foreseeable."230

The plain implication of this sentence is that, except in procurement fraud and product substitution cases, loss includes "only direct damages."23, Thus, the Commission appears to endorse, almost as an aside and with no effort at elaboration, a general rule about causation: Except in procurement fraud and product substitution cases, "direct damages" are included in loss, but "consequential damages" are not.232

The choice of the phrase "consequential damages" as the linchpin of a rule about sentencing causation could scarcely have been less fortunate. "Consequential damages" is a term of art drawn from the law of contracts.233 Other than in the Guidelines, it is used nowhere else in the criminal law. The attempt to translate the term from contract to sentencing law creates numerous problems. First, the law of contracts concerns agreements, principally commercial agreements.234

It presupposes identifiable promises between known contracting parties.235 Its purpose is to protect and enforce, so far as is reasonable and desirable as a matter of policy, the expectations arising from the promise or promises which make up the contract.236 In consequence, the law of remedies for breach of contract is primarily concerned with ascertaining the scope of the agreement and securing to the nonbreaching party, as far as possible, the benefit of his bargain,237 or, where that is not possible or desirable, restoring the injured promisee to the position he was in before the agreement was made.23s

By contrast, economic crimes need not involve any promise at all, much less a legally enforceable agreement. Crimes in the larceny family are customarily crimes of stealth and require no acquaintance between thief and victim, much less an agreement. The same is true of crimes involving receipt of stolen goods and destruction of property.

Other basic crimes of dishonesty like embezzlement may arise in the context of a contractual relationship, as for example, an employment contract incident to which the defendant obtains lawful possession of property later embezzled. But an embezzler need not be party to an employment contract, and in any case the purpose of

prosecuting and perhaps imprisoning an embezzling employee is not to protect the employer's expectation interest in the fulfillment of an express or implied promise not to convert certain goods.239

Fraud cases often do arise in contractual settings. Obvious instances include loan fraud and procurement fraud.240 But just as often there is either no contract in the case,241 or the person who suffers an economic loss is not a party to any contract with the defendant.

A good example of the latter situation is the Harper equity skimming case discussed above,242 in which the defendant entered into contracts with the homeowners to assume their mortgages, and contracts with the renters to provide housing. He breached both sets of contracts. Yet the major economic losers in the case were not the homeowners or renters who contracted with the defendant; those parties either lost little or received most of what they bargained for. The true losers were the banks and the federal government, neither of which contracted with the defendant at all.

Thus, in economic crime cases in which there is no readily identifiable contract, or in which the loss was inflicted on someone not party to any contract breached by the defendant, the distinction between direct and consequential damages provides a sentencing court no useful guidance. How does one decide which economic harms are the direct, and which the consequential, results of the breach of a contract that never existed? In United States v. Marlatt,243 the Seventh Circuit suggested that the Sentencing Commission adopted the prohibition on consequential damages in order "to prevent the sentencing hearing from turning into a tort or contract suit."244

Unfortunately, the court got it backwards. Regardless of what the Commission's intent may have been, the unavoidable effect of using a contracts term in criminal sentencing is precisely to transform the sentencing process into a piece of contract litigation.

More troubling than the general analytical conundrums occasioned by injecting contracts terminology into criminal sentencing law are problems specific to the phrase "consequential damages." Modern law on consequential damages is generally conceded to be a refinement of the holding in the classic English case of Hadley v. Baxendale.245 (For those who recall from first year Contracts class the brain-twisting holding of Hadley, this historical fact alone should create some reluctance to bring "consequential damages" into the criminal law.) Foreseeability is the modern test of whether some alleged economic harm caused by a breach of contract is recoverable as a "consequential damage."246 If the harm to the plaintiff was reasonably foreseeable to the breaching defendant then it is ordinarily recoverable by the plaintiff absent some special contractual provision excluding such recovery.247

The distinction between direct and consequential damages is routinely litigated in contract cases. However, in contract cases in which damages become an issue there is, by definition, an agreement consisting of particular promises, at least one of which has been broken. In that context, it makes sense to speak of direct damages as the monetary value of the broken promise-the cost to the buyer of replacing an undelivered shipment of wheat or to the seller of producing a shipment of shoes for a shop that refuses delivery-and of recoverable consequential damages as the foreseeable additional consequences flowing from the breach. In economic crime cases where there is no contract to serve as a frame of reference, the contract terms "direct damages" and "consequential damages" are stripped of their particular meaning and become, not an actual distinction, but, at best, a sort of metaphor or illustration of the kind of distinction the Commission had in mind. In this view, Application Note 7(c) means something like, "Sentencing courts should not consider harms of the general sort described in contracts cases as 'consequential damages.' "

It will come as no surprise that courts have experienced considerable difficulty in applying the consequential damages concept to sentencing. The Sixth Circuit has held unequivocally that loss does include "incidental and consequential damages."248 Other circuits routinely intone that loss does not include consequential damages.249

Indeed, the Eleventh Circuit has found that the Sentencing Commission's intention to exclude consequential damages from the loss calculation is so clear that such damages may not generally be taken into account even in justifying a departure.250 Nonetheless, it is extraordinarily difficult to discern from the cases any principled dividing line between "loss" and "consequential damages."

An examination of the case law reveals how confused courts are on this issue. In United States v. Wilson, the Eleventh Circuit vacated the sentence imposed by the district court judge assessing against the defendant the full amount of loans promised in an advance fee scheme, even though no loans were ever made.251 To justify including the full amount of the promised loans, the district court relied on skimpy testimony from individual victims regarding feelings of embarrassment and actions such as quitting jobs taken in detrimental reliance on the expectation of a loan.252

In the Ninth Circuit case of United States v. Mende, the defendant's company guaranteed large loans and obtained advance fees for channeling loans to banks.253 The district court charged the defendant with a loss including $ 3 million for the advance fees, $ 13 million for defaulted loans guaranteed by the defendant's companies, stock losses of $ 647,000, and additional actual losses of $ 500,000.25 The defendant, relying on the Eleventh Circuit's opinion in Wilson, claimed that all losses except the advance fees should be excluded as incidental and consequential damages.255

The Ninth Circuit disagreed and upheld the district court. The court distinguished Wilson by pointing to a closer causal connection between the losses and the fraud in the present case than had obtained in Wilson: "Unlike Wilson, there can be no doubt that Mende's fraud cost his victims more than just advance fees. In this case the district court found the victim banks' losses to be the direct result of the defendant's fraudulent misrepresentations, rather than mere consequential and incidental damages."25 The Mende court was undoubtedly correct in finding Wilson factually distinguishable; the causal connection between the losses and Mende's conduct was more direct than in Wilson, and it rested on less speculative evidence. The interesting part of the decision, however, is that Mende defined the difference between "loss" and "consequential damages" purely in terms of causation. For the Mende court, economic harms that have a close causal relationship to the crime are "loss." Harms that are more causally remote or are connected to the crime by speculation are "consequential damages" and therefore not "loss."57 Although as a matter of policy this is not a bad rule (or at least portion of a rule) for defining "loss," it requires distorting the customary meaning of "consequential damages."2r8 In contracts, if consequential damages are directly caused by the defendant's misconduct, as they often are, and if they were foreseeable, the defendant is responsible for paying them.

The Seventh Circuit's decisions on consequential damages are particularly challenging. In United States v. Marlatt, the defendant, the owner of a local title company, bought a resort property and secured title insurance policies on time-share units at the resort by lying to the national title insurance company (for which he was the local agent) about the existence of extensive liens and other encumbrances.259 He sold the units to individuals who agreed to buy in reliance on assurances of clear title (as well as on assurances of the resort's overall sound financial condition implicit in the title documents). When the defendant's fraud was discovered, the insurer had to pay over $ 476,000 to clear the titles. The resort went bankrupt and closed, rendering the time-share units

virtually worthless. The insurer, under threat of suit from the individual owners,260 spent an additional $ 565,000 to purchase the units from them and forestall the suit.

Judge Posner, writing for the panel, concluded that the $ 476,000 paid by the insurer to remove the encumbrances and fulfill the terms of its policies was "loss," but that the costs incurred to buy the resort and forestall a lawsuit were not. The Marlatt opinion has been cited frequently,261 and deserves careful examination.

The court began by getting the "who's the victim?" question wrong. Judge Posner identified only the title company as the victim, and emphasized that the company made a business decision to reimburse the time-share owners, a decision which was in his view neither legally required nor caused by the defendant's fraud. He apparently thought that, because the company volunteered to assume this expense, the sentencing court could not then charge it to the defendant.

The defect in this reasoning is that the economic harm represented by the $ 565,000 the company paid to purchase the worthless apartments would have been suffered by the individual owners had the company not acted. The defendant's scheme was never directed at the title company, except incidentally. The true object of the scheme was to obtain money from time-share buyers by misrepresenting the condition of the titles to individual units, and more importantly by explicitly or implicitly misrepresenting the overall financial soundness of the entire resort. The individual buyers were induced to part with $ 565,000 in reliance on the defendant's falsehoods and forgeries.

Even if the indictment in the case did not identify the purchasers as victims of the scheme to defraud (and one cannot tell from the opinion), the fraud practiced upon them was unquestionably relevant conduct under section 1B1.3. Thus, the owners were victims just as much as the title company. The fact that the title insurer decided to reimburse the individual owner-victims for their losses no more erases those losses from the sentencing calculus than would the business decision of a property insurer to recompense a burglary victim for stolen items not covered by a homeowner's policy.

Judge Posner implicitly addressed the weakness in the approach of identifying the insurer as sole victim by going on to hold that the collapse in value of property at the resort was not caused (except, as he says, "in the sense. . . of 'but for' causality"262) by the defendant's fraud. "The fact that the purchasers would not have purchased the time shares had it not been for the title insurance policies issued by Ticor would not make Ticor an insurer against a drop in the real estate market."263 Judge Posner noted that more than mere "but for" causation has historically been required for the imposition of criminal liability. However, in what at first glance appears a peculiar omission, he neglected to identify what that something more might be, saying only that "(t)he distinction runs throughout the law.

Criminal law is no exception."264 It is nonetheless plain that the "distinction" to which he alluded is the foreseeability element of traditional proximate cause analysis.265

Finally, Judge Posner said that "even if" the plunge in value was caused by the fraud, the money paid by the insurer to compensate the owners was a consequential damage excluded from loss by section 2F1.1, Application Note 7(c).266 Aided by the fact that Marlatt did contain a contract, the court nicely melded the guideline definition of loss with traditional contract law on consequential damages: The defendant extracted from Ticor (the title insurer) by fraud a bunch of insurance policies on which Ticor was required to make good to the tune of $ 476,000. This was the loss. In the wake of the loss Ticor incurred other expenses, which were consequences, perhaps even foreseeable consequences, of the fraud, but were not the thing actually taken from Ticor, the loss; the thing taken was the promise to insure and the cost of honoring that promise was $ 476,000 267

The reason for Judge Posner's odd reticence about defining the "distinction (that) runs throughout the law" now becomes clear.

Evidently, he was reluctant to point out that foreseeability is the nearly universal "distinction" between those harms chargeable to civil and criminal malefactors and those that are not, because, in contrast to the Ninth Circuit in Mende, Judge Posner held in Marlatt that even economic harms directly and foreseeably caused by a defendant's conduct are excluded from "loss" if they are "consequential damages." This is, in my view, a regrettable outcome as a matter of policy (a point to which we will turn momentarily). Nonetheless, at least as to the victim title company, Judge Posner's opinion provides a reasonably convincing interpretation of the Guidelines as now written.261

Less than a year later, the Seventh Circuit decided United States v. Barrett, a case presenting facts nearly identical to those in Marlatt.269 Defendant Barrett induced a title company to issue clear title commitments based on false representations that existing mortgages had been satisfied. He also made false statements directly to a federally insured savings and loan (KS & L") asserting that lots pledged as collateral for construction loans were free of encumbrances. He was convicted of making false statements to a federally insured lending institution.

After discovery of the fraud, the title company made good on its insurance policy by paying off the existing lienholders. The S & L then foreclosed on the lots, but suffered a loss because the loan amounts exceeded the foreclosure proceeds. The government argued that both the title insurance payout and the S & L's loss due to decreased value of its collateral were components of the loss. The

Seventh Circuit agreed.

The court did not dispute Barrett's contention that the loss to the S & L in this case was a "consequential damage" of precisely the same sort suffered by the time-share buyers in Marlatt and excluded from loss by Judge Posner. Indeed, the Barrett court cited Marlatt for the proposition that "(a) loss due to reduced market value, whether it is borne by the property owner or the title insurer, is consequential and is not a loss attributable to the title fraud."270 The court nonetheless distinguished Marlatt on the ground that the victim in Barrett was a financial institution, and section 2F1.1, Application Note 7(b) regarding fraudulent loan cases includes as "loss" the decline in value of collateral between the fraud and liquidation of the collateral.

Obviously uncomfortable with the disparate results dictated by the Guidelines, the Barrett court supported the differential treatment of the title insurer in Marlatt and the federally insured lender before it on the ground that the defendant's misrepresentation to the S & L induced the S & L to make a loan it would not otherwise have made by distorting the bank's initial assessment of "the actual likelihood of his defaulting on the loans."271 The distinction is unconvincing. After all, did not the defendants' misrepresentations to the title companies in both Barrett and Marlatt cause them to miscalculate the risks they incurred by issuing title insurance policies? The issue in both cases was not whether the defendant's misrepresentations caused victims to part with their money. They did. The issue in each case was whether the defendant's conduct had a sufficient causal connection to the fact that victims lost money when the property he induced them to buy (or accept as a security) declined in value to justify holding him responsible for such losses at sentencing. The law of the Seventh Circuit on consequential damages and loss remains murky.2?2

For its part, the D.C. Circuit seems to find persuasive the Ninth Circuit's approach in Mende. In United States v. Gottfried, the defendant was an Attorney Advisor to the Board of Veterans' Appeals in the Department of Veterans Affairs.273 To save himself work, he removed documents from the files of appeals of regional office decisions denying eligibility for disability benefits, and recommended remand of the cases to the regional

office because of incomplete files.274 The defendant was convicted of concealment, removal, and mutilation of government records.275 The district court counted as part of the loss the costs incurred by the Board in reprocessing the thirty-two appeals known to have been tampered with by the defendant.

The D.C. Circuit approved, despite the inclusion of costs to the government such as the pro rata overhead expenses of running the Board.27? The court analogized the inclusion of overhead expenses to awarding attorney's fees in a civil case.277 Said the court: "Including pro rata overhead expenses in the amount of the Board's loss . . . for reprocessing the thirty-two appeals merely attributed to Gottfried the cost of undoing the damage he had done."278

The court distinguished Marlatt and other cases that exclude consequential damages,279 remarking: "Perhaps more may be discerned, but at the least the cases stand for the general proposition that only 'direct' losses count."280 In the hands of the Gottfried court, the "no-consequential-damages" rule is transmuted into little more than a requirement of "but for" causation.281

4. Consequential Damages in Procurement Fraud and Product Substitution Cases

As troublesome as the general exclusion of consequential damages from loss has proven in practice, the mandate of section 2F1.1, Application Note 7(c), that such harms be included in loss in procurement fraud and product substitution cases is perhaps even more puzzling as a matter of policy.282 It is not readily apparent why these categories of cases should be treated differently. For example, why should the "reasonably foreseeable costs of making substitute transactions" and "the reasonably foreseeable administrative cost to the government and other participants of repeating the procurement action affected"2 be chargeable to the defendant in procurement cases when similar costs incurred by governmental and other victims in non-procurement cases are not?

The explanation offered in note 7(c) for the special treatment of procurement and product substitution cases-that consequential damages "frequently are substantial in such cases"-is hardly adequate. In the first place, the unstated implication that consequential damages in other types of cases are generally insubstantial is, at best, questionable. Second, if the concept of "loss" does not include consequential damages, then the fact that such damages happen to be large in one category of crimes is hardly an explanation for changing the definition.2s4

Indeed, it is plain that some courts have been unable to fathom the reasoning behind the distinction. Gottfried, for example, is a case in which the loss measurement sanctioned by the D.C. Circuit can fairly be described as either "the cost of making substitute transactions" or "the reasonably foreseeable administrative cost to the government . . . of repeating the . . . action affected."2 Notwithstanding their authors' protestations to the contrary, Gottfried and Mende are both cases in which economic harms that would in any other context be termed consequential damages were made part of the loss.

5. Causation and Multiple Factors

The issue of multiple causation commonly arises when a defendant's conduct has apparently caused some actual loss to the victim, but the defendant alleges that but for the intervention of unforeseen factors, the loss would have been smaller or would not have occurred at all. Consider, for example, a victim who purchases stock based on a defendant's fraudulent misrepresentations about its value, and then sees the stock decrease in value still further because of an unforeseen downturn in the stock market after the purchase.

From one point of view, the only loss directly caused by the defendant in this case is the difference between the price the victim paid for the stock based on the representations by the defendant and the actual (lower) market value of the stock at the time of purchase.216 On the other hand, but for the defendant's blandishments,

the victim would not have been holding the stock to begin with and thus would not have suffered the additional harm caused by the market decline. The fundamental issue is the nature and strength of the required causal nexus between a defendant's criminal conduct and the loss charged to him under the Guidelines.

The Guidelines themselves provide somewhat conflicting advice on this problem. The only direct reference to multiple causation in either the theft or fraud guideline is in Application Note 7(b) of section 2F1.1, which suggests that the amount of loss caused287 by the defendant's conduct may overstate the seriousness of the offense if there existed some cause or causes extraneous to the defendant's misbehavior.28 The example given is an unanticipated economic event like a grain embargo.2?9 In such a case, the suggested remedy is a downward departure.2?

By contrast, as noted above in the discussion of United States v. Barrett,291 the very same application note says that loss in fraudulent loan cases will be determined by taking the unpaid balance of the loan at the time of discovery of the fraud and subtracting the amount the "lending institution has recovered (or can expect to recover)" from liquidation of the collateral.292 The commentary does not exclude from the loss calculation the increase in "loss" which necessarily occurs whenever the value of pledged collateral decreases due to changed market conditions, natural disaster, or other factors arising between the making of the loan and the liquidation of the collateral after discovery of the fraud. Where the victim is a bank, the defendant is responsible for the bank's entire loss, whether or not multiple factors are present.

The Guidelines provide no guidance on the question of when losses arising from external factors should be attributed to the defendant and when the connection between the external factor, the defendant's conduct, and the victim's loss is so attenuated that some adjustment should be made by actual modification of the loss amount or by departure. Courts have wrestled with this problem with indifferent success. Some appear to recognize that adjustments to "loss" for multiple causation may be appropriate in certain cases.293 On the other hand, the Third Circuit is of the view that multiple causation can only be a ground for a downward departure.294

6. Causation: A Summary of the Status Quo What then can we divine about the required causal relationship between a defendant's criminal behavior and those economic harms the Guidelines now count as "loss"? In truth, the Guidelines and the cases construing them have created an ugly and nearly incomprehensible patchwork: a. The Guidelines contain no rules for determining the identity of victims whose losses will be taken into account for sentencing purposes.

b. The relevant conduct guideline says that offense levels are to be determined based on "all harm that resulted from"296 a defendant's own conduct, apparently setting up a rule of pure "but for" causation.

c. By contrast, both the fraud and theft guidelines define "loss" narrowly as the "thing taken," the corpus delicti of the crime.

d. Moreover, section 2F1.1, Application Note 7(c), says that only "direct damages" count for the purpose of determining loss, and excludes from consideration "consequential damages." If the latter term is given its customary meaning, Note 7(c) excludes from loss many economic harms which are both foreseeable and directly caused by defendant's conduct. _..As e. On the other hand, in cases of procurement fraud and product substitution the Guidelines specifically include "consequential damages" in loss, if such "damages" were foreseeable.

f. Likewise, if a defendant has co-conspirators or other criminal cohorts, he is responsible for all harms that resulted from all of their "reasonably foreseeable acts and omissions" in furtherance of the crime.

g. In loan fraud cases, a drop in value of pledged collateral is a part of the loss to banks, despite the fact that such loss is a classic "consequential damage." Moreover, the rule is so broad that such losses are counted regardless of whether the decline in value was caused by factors wholly extraneous to the crime and regardless of whether it was foreseeable to the defendant.

h. Except in loan fraud cases, if a victim's loss is genuinely attributable to several causes, there is no rule for determining what the causal nexus to a defendant's conduct must be before the loss should be counted.

i. In any case, courts routinely evade the noconsequential-damages rule by ignoring it or by interpreting it to impose something like a rule of proximate causation.

B. Causation: A Path Out of the Swamp

Judge Posner is exactly right when he says in Marlatt that the idea of causation "runs throughout the law" as a distinction between liability and non-liability.2? As we noted at the outset, causation is one of the principal requirements, along with an act or omission and a culpable mental state, for a determination of fault for crime.297 The distinction between harms said to have been "caused" or "not caused" by a party's misconduct is also central to torts and contracts. More to the point for present purposes, and as I hope the foregoing discussion has demonstrated, many, perhaps most, of the difficulties in deciding which economic harms to include in loss under the Guidelines are at bottom problems of causation. In any theory of liability for harm, whether civil or criminal, and in criminal cases whether at the guilt or sentencing phase, the indispensable link between the defendant's conduct and a harm for which the law seeks to impose responsibility is a definition of causation. When the drafters of the Guidelines created a sentencing scheme for economic crime which made measurement of harm the predominant sentencing factor, but failed to define the required causal relation between the criminal conduct and the harm to be measured, the current thicket of uncertainty became not only predictable, but inevitable.

I hasten to add that by "causation" I do not refer only to the purely mechanical relation of cause and effect between defendant's conduct and a particular harm, though this is certainly one component of the problem. While causation analysis takes slightly different forms in different disciplines, two elements are common to causation analysis throughout the law: (1) a requirement of cause-in-fact, that is, a logical cause and effect relationship between the conduct complained-of and the harm for which liability is sought; and (2) what might be termed "cause in law," that is, some formula for cutting off infinite liability for remote and unpredictable consequences, and thus for keeping legal responsibility within

reasonable limits.

To be doctrinally coherent and practically useful, a consolidated economic crimes guideline must have rules concerning each of these elements of causation. Indeed, the Commission should abandon its current dysfunctional larceny-based definition of loss and redefine the term expressly in terms of cause. In the following Section, I propose such a definition in the form of a draft application note, and then analyze the language of the draft.

1. Loss Redefined

The Sentencing Commission should redefine "loss" in application notes to a consolidated economic crimes guideline as follows:

Application Notes:

1. 'Zoss" means all pecuniary harm caused by the acts and omissions specified in subsections (a)(1) and (a)(2) of 1B1.3 (Relevant Conduct) that was reasonably foreseeable to the defendant at the time of such acts or omissions. 'Victims" are all persons or entities (public or private) which suffered such harms. (a) Pecuniary harm

The phrase *pecuniary harm" is to be given its common meaning. Many physical and emotional harms, injuries to reputation, etc., can be assigned a monetary value. However, "loss" does not measure harms of this kind. Its purpose is to measure economic harms. Cause-in-fact

A harm has been 'caused' for the purposes of this guideline if one or more of the acts or omissions specified in subsection (a)(1) or (a)(2) of 1B1.3 (Relevant Conduct) was a substantial factor in producing the harm. 'Loss' should not include harms that are causally remote from the specified acts or omissions. (c) Foreseeability

A foreseeable harm is one that ordinarily follows from one or more of the acts or omissions specified in subsection (a)(1) or (a)(2) of 1B1.3 (Relevant Conduct) in the usual course of events, or that a reasonable person in the position of the defendant would have foreseen as a probable result of such acts or omissions... Loss does not, however, include costs incurred by government agencies in criminal investigation or prosecution of the defendant.

In Cases of theft. receipt of stolen pretenses, embezzlement, and destruction of other forms of thefn, as well as cases involving larceny, false pretenses, embezzlement, and other forms of theft, as well as cases involving receiptruction or damage of property, loss includes, property not be limited to, the ualue or the destruction or damage of property, loss includes, but damaged, not be limited to, the value of the property stolen, embezzled, damaged, or destroyed. (e) Congressional intent

In determining the loss (including the identification of the persons or classes of persons to be treated as victims), the sentencing court shall give particular weight to congressional intent. It shall be rebuttably presumed that pecuniary harm which was: (i) caused by one or more of the acts or omissions specified in subsection (a)(1) or (a)(2) of 1 lBl.3 (Relevant Conduct); and (ii) suffered by any person or class of persons whose interests Congress intended to protect by passage of the offense(s) of conviction or offense(s) considered by the sentencing court as relevant conduct, was foreseeable to the defendant. For example, in a case involving diversion of government program benefits, loss is the value of the benefits diverted from intended beneficiaries or uses. Similarly, in a case involving a Davis-Bacon Act violation (a violation of 40 U.S.C. 276a, criminally prosecuted under 18 U.S.C. 1001), the loss is the difference between the legally required and actual wages paid.

Interest

Loss shall include interest if interest or some other similar form of return on investment was bargained for by a victim as part of a transaction which is the subject of the count(s) of conviction, or which is included as relevant conduct under 1B1.3. In such a case, loss shall include a component of interest at the statutory rate specified in 28 U.S.C. 1961 calculated from the time at which the money, property, or other thing of value was stolen, embezzled, damaged, or destroyed, or the victim was otherwise deprived of its use or benefit, until the time the crime was detected. In all other cases, loss shall not include interest.

2. Analysis of the Proposed Redefinition of Loss

In drafting this new definition of loss, I have tried to balance several sometimes cross-cutting principles. First, harm matters in ranking offense seriousness; the Guidelines' general modified real offense structure, together with the specific mandate of the relevant conduct guideline to include in the offense level "all harms resulting from" a defendant's crimes, strongly suggest that loss should be a broad-based measure of the

economic harm caused by the defendant's criminal behavior. On the other hand, criminal law is preeminently about fault. If a man is to be confined in a locked room for months or years because someone has suffered a pecuniary loss, then we must be able to say that the loss.was his fault in more than an arid logical sense. Therefore, in defining for sentencing purposes the required nexus between harm and criminal behavior, I have sought to put into words what I think the Commission has always intended, and what sentencing courts construing the convoluted loss rules have struggled to achieve-that a defendant should be sentenced on the basis of all harms, but only those harms fairly attributable to the wrongs he committed.

a. Cause in Fact

The minimum requirement imposed by any definition of legal cause is that the defendant's conduct be a "necessary antecedent to the harm at issue."298 This requirement is often referred to as "but for" causation. The Guidelines' definition of "loss" must at the very least require "but for" causation. If a harm would have happened regardless of defendant's behavior, there can be no justice in punishing him for its occurrence. Presumably the relevant conduct guideline refers to "but for" causation when it lays down the general mandate that offense levels are to be determined by considering "all harms resulting from" certain conduct.299

The more difficult definitional issue arises in deciding whether to impose on the loss calculation a standard of logical causality stricter than pure "but for" causation. Chains of cause and effect once initiated, run on infinitely through time.300 It has been argued that attempts to limit legal liability by defining the logical proximity of conduct to harm are doomed to failure.*1 In this view, language is so imprecise and circumstances are so various that no verbal formula can achieve a useful degree of precision. Moreover, most arguments about causation in both criminal and civil law are less about cause-infact than about foreseeability, that is, whether the defendant anticipated, or should have anticipated, the harm at issue.

Nonetheless, it may be useful to adopt as part of the loss definition a standard of cause-in-fact more stringent than "but for" causation. It seems plain both from existing Guidelines' language and the case law that neither the Sentencing Commission nor the courts are disposed to count as "loss" harms logically remote from a defendant's conduct or to which his conduct made only an insubstantial contribution. The definition proposed here maintains continuity with that established approach, and is consistent with the general principle of criminal fault that people should be sent to jail only for harms to which they have a significant connection.

Among the various phrases that have been used over the years to describe a more-than-but-for standard of cause-in-fact, the "substantial factor" language first proposed by Jeremiah Smith3o2 and later adopted by the Restatement of Torts,303 has three notable advantages. First, it does not employ the term "proximate cause," a phrase redolent of the liberal causation rules of tort law,30 and which is, in any case, mostly concerned with foreseeability. Second, it allows sentencing courts to make sensible limiting choices about cause-infact without having to make the tortured analogies between the situations before them and the law of larceny or contracts now required by the use of ill-fitting terms of art like "taken" and "consequential damages." Third, it suggests an approach to cases involving multiple causes more useful than the Guidelines' current glib dismissal of the problem as one to be dealt with by departure.

b. Foreseeability Throughout the law, foreseeability of harm is a primary component of rules designed to place limits on liability for harm a defendant caused in fact. In torts, liability is commonly imposed for negligence,30 and the linchpin of negligence law is "proximate cause." A defendant is civilly liable for negligence if he breaches a legal duty and the breach is the proximate cause of actual loss or damage to the interests of another.30 However, logical causation is a necessary but not sufficient condition for a finding of proximate cause. Instead, proximate cause is customarily defined primarily by reference to consequences that

might ordinarily be anticipated, either by this defendant or by the ubiquitous "reasonable man," a requirement usually denominated "foreseeability."307 Likewise in contracts, as observed above, the determinant of whether consequential damages arising from a breach of contract are recoverable is whether such damages are foreseeable.308

The definition of foreseeability in torts and contracts differs markedly,309 primarily because the two bodies of law exist to serve different social ends. Torts, although concerned with fault, is equally concerned with the more pragmatic goals of compensating injured persons, restoring their productive abilities, and encouraging social mechanisms for sharing the cost of injuries incident to communal life.310 Consequently, tort law has tended to define foreseeability quite broadly, never quite saying that if a harm happened then it must have been foreseeable, but at times reaching toward that extreme.

Contract law is more narrowly concerned with the fulfillment of private agreements, and has been written against the background of concern that the law not burden beneficial business activity with crippling liability for the occasional breaches of promise which are an inescapable feature of commercial life.gll As a result, contract law has taken a narrower, more subjective and therefore more restrictive view of foreseeability,312 insisting as did the court in Hadley v. Baxendale3ls that a defendant have been warned of the harm at issue or that a reasonable person in defendant's circumstances, knowing what he knew, would have anticipated the harm.

Although the question is less often discussed in criminal law,314 foreseeability is also a hallmark of criminal causation,315 and has long been a staple of analysis both in determining guilt and in imposing sentences. In guilt determinations, foreseeability is, of course, expressly an element of crimes where the prohibited mental state is criminal negligence31 or recklessness.317 It is also integral to determinations of guilt for crimes in which the ostensible mens rea involves intentionality or knowledge.3?8 For example, a party to a conspiracy is responsible for any crime committed by a co-conspirator if it is within the scope of the conspiracy or is a foreseeable consequence of the unlawful agreement.319 Similarly, a criminal accomplice "is guilty not only of the offense he intended to facilitate or encourage, but also of any reasonably foreseeable offense committed by the person he aids and abets."320 The felony murder rule, which imposes liability for the highest available degree of criminal homicide for killings occurring during certain dangerous felonies, in effect substitutes foreseeability of death for the intent to cause it.321

Foreseeability of harm is also widely employed as a determinant of which harms to consider in sentencing. As observed above, the Guidelines themselves repeatedly use foreseeability to distinguish between those harms that count for measuring offense seriousness and those that do not.322 This approach has received the imprimatur of the United States Supreme Court, even in the capital sentencing context. In Payne v. Tennessee,323 the Court approved the use of victim impact evidence over the objection that such evidence concerns "factors about which the defendant was unaware, and that were irrelevant to the decision to kill," and thus has nothing to do with the "blameworthiness of a particular defendant."324 Justice Souter, in his concurrence, responded to this argument by observing that the harms to the surviving victims of homicide (the families, friends, communities, and loved ones of the deceased) portrayed in victim impact evidence are morally, and therefore legally, relevant precisely because they are so plainly foreseeable.325

The inclusion of foreseeable harms in the sentencing calculus is not only sanctioned by long precedent, it is entirely consistent with the fundamental principles and purposes of criminal sentencing.

Again, criminal law is preeminently about fault. It is unjust to put someone in prison for harms he did not intend or that he could not reasonably have anticipated would follow from his choice to do wrong It is entirely

appropriate, however, to punish based on harms that would not have occurred but for the defendant's evil choices, and that the defendant either anticipated or could and should have anticipated

Because the emphasis in criminal law is on fault, the definition of what is foreseeable for sentencing purposes should be relatively narrow. Accordingly, I have borrowed language from contract law326 that emphasizes two points: (1) Although the idea of foreseeability is, by definition, an objective standard (we ask not what the defendant did foresee, but what he could have foreseen), the definition I have chosen requires that the harm have been foreseeable to this defendant given the facts available to him at the time he acted; and (2) the proposed standard requires that a reasonable person in defendant's shoes "would have foreseen" the harm in question "as a probable result."

The combination of a more-than-but-for cause in fact standard and a tougher-than-tort-law foreseeability standard should produce several practical results. First, the universe of pecuniary harms that count as loss will be somewhat larger than is now the case. In my view, such a result is desirable as it will provide a closer congruence between the true harm caused by economic offenders and the sentences they serve.327 Nonetheless, by specifying a relatively restrictive definition of foreseeability, the Commission would signal that the scope of loss is not limitless, and is instead confined to harms for which a defendant can justly be held accountable.

Second, the new rule should simplify the task of sentencing economic criminals. Some will contend that the rules proposed here will impose a far greater fact-finding burden on courts.328 I disagree.

Zealous government advocates in search of more severe sentences will present roughly the same evidence and arguments whether or not the changes advocated here are adopted. Zealous defense counsel will argue just as strenuously that the harms urged by the government have not been proven, or if proven, should not count. The only difference will be that courts will draw the lines of inclusion and exclusion from '*loss" in different (and I hope easier to find) places. District courts are very well equipped to make findings of fact. That is, after all, their job. The problem with the loss calculation has never been the factual issues; it has been with trying to apply an incomprehensible set of conflicting rules to well understood facts.

As some workingman's sage once observed, the key to success in any undertaking is having the right tools. The current Guidelines use the wrong verbal tools to define loss, tools designed for other tasks. The core issues in defining loss are questions about causation-cause-in-fact and foreseeability. The Guidelines should deal with these questions squarely and give sentencing judges the definitional tools they need to make case-by-case decisions. Judges do not know how to merge larceny language ("taken") with contracts terminology ("consequential damages"). They do know how to determine cause-in-fact and foreseeability. The Commission should let them.

c. Victims and Gain

I am of two minds on the subject of using a defendant's "gain" as an alternate measure of "loss." On the one hand, the issue of gain arises primarily because the present Guidelines tend to obscure the identity of the true victims in criminal transactions. As explained above,329 the problem of identifying victims is in reality a problem of defining the requisite causal relation between the defendant's conduct and the harms for which we wish to hold him answerable at sentencing. Once the cause riddle is solved, the question of who is the victim answers itself and the need to use "gain" as an alternative measure of loss largely evaporates. A consideration of gain is currently necessary primarily because the present Guidelines tend to obscure the identity of the true victims in criminal transactions. In a regime in which the sentencing court is at liberty to identify all reasonably foreseeable victims of a defendant's conduct and aggregate their economic injuries in the loss calculation, gain

as an alternative measure of loss should be superfluous. Therefore, the proposed consolidated guideline contains no reference to gain.

On the other hand, colleagues at the Commission and the Department of Justice have argued persuasively that there are some cases, particularly frauds involving numerous victims with small individual losses, in which proving loss directly victim-by-victim is prohibitively difficult,330 while proving the defendant's aggregate gain is perfectly practical. It may be that some provision permitting the use of gain should be retained in the Guidelines to account for those unusual cases. If so, gain should be used only as an alternative measure of loss when more direct measures prove impracticable.

d. The Object of the Crime

I have included in the proposed guideline application notes31 a paragraph designed to emphasize continuity with the current primary definition of loss, the "value of the thing taken, damaged, or destroyed."32 "Loss" under the new regime would begin with the value of the object of the crime, the money or property stolen or embezzled or destroyed by the defendant. However, the revised language eschews the confusing word "taken," and makes clear that the loss calculation always begins, but may not end, with the value of the immediate criminal object.

e. Legislative Intent

As discussed above,333 the punishment for any crime should be related to the damage inflicted on interests the legislature sought to protect by proscribing the behavior at issue. Given the cornucopia of federal economic crime statutes, any attempt by the Commission to identify and account for all the interests Congress has sought to protect would introduce not clarity, but clutter. The solution is, once again, to let courts do what they already know how to do-in this case determine legislative intent. If there is any question about whether a particular type of economic harm was contemplated by Congress, sentencing courts will apply well understood tools of statutory construction to divine legislative intent.

Because the primary consideration in assessing loss is fault, I have made legislative intent not conclusive, but presumptive evidence of foreseeability. Doing so not only assigns to the legislature its appropriate role, it comports with common sense. If the connection between a particular crime and a particular type of harm was suficiently clear that Congress bestirred itself to pass a law criminalizing the conduct to prevent the harm, the occurrence of the harm as a consequence of the crime should be reasonably foreseeable to the average perpetrator. Still, exceptional cases will arise and a defendant should be permitted to prove that a connection clear to Congress was neither clear nor foreseeable to him.

f. Causation and the Problem of Interest

The question of whether a defendant should be assessed interest as a part of "loss" is merely a special case of the general causation problem. A proponent of including interest would argue that the defendant's fraud or theft causes not only a loss of the thing stolen, but also the loss of an income stream which would have been generated had the defendant not stolen the asset. Opponents of including interest in "loss" would respond that the causal relationship between the defendant's conduct and a hypothetical income stream is too speculative: In general, we cannot say with confidence how a victim might have used the stolen asset had it not been stolen, or how productive that use might have been.

The Sentencing Commission has sided with the opponents of including interest, stating in Application Note 7 to the fraud guideline that loss "does not ... include interest the victim could have earned on the funds had the offense not occurred."34 Despite the apparent clarity of the commentary, at least five circuits have held that

interest should be counted if it was specifically bargained for by the victim in the transaction which is the subject of the criminal case.335

The flaw in the reasoning of courts including agreed-upon interest in loss becomes apparent when we recognize that banks are not the only victims to whom fraud defendants promise to pay interest. The promise of a return on investment is a staple of virtually every con game ever devised. The implication of the cases that count interest promised by contract as "loss* is that the loss caused by any fraud defendant should be measured by the promises he makes but does not keep. By this logic, if the friendly man on the phone guarantees a 10% monthly return on my investment, my "loss" must then be the amount I send him plus the promised 120% per annum.

The only way to escape this parallel is to argue that the interest a defendant promises to pay a bank on a fraudulently obtained loan, or a credit card company in a credit card fraud scheme, is "commercially reasonable," while the expectations of the ordinary noncommercial fraud victim are not.336 After all, a telemarketer's promise to pay 120% annual interest on the money I send him is distinguishable from my promise to pay the bank 8% interest on the money it lends me only by the differing probabilities that the two promises will be kept. The Fifth and Sixth Circuits seem to have an inkling of this difficulty because both qualify their opinions by saying contractually promised interest should be included in loss where the victim had a "reasonable expectation" of receiving it.337 Trying to make this distinction takes courts down a very difficult path. For example, if a bank makes a self-evidently risky loan without following customary industry procedures, is that behavior commercially reasonable? Or if a credit card company fails to have a theft detection system or issues cards to people with bad credit histories, is that commercially reasonable?

Several courts, particularly the First Circuit in United States v. Goodchildm and the Seventh Circuit in United States v. Allender,9 emphasize that including interest in loss is justified where the defendant agreed to pay it and the lending institution relied on that promise in extending credit. But such reliance is present in every fraud case-the defendant promises the victim his money back plus a profit, the victim relies on those promises and writes a check. Holding the defendant to his promises has a superficial appeal, but it strays a very great distance from the concept of loss as something the defendant actually took or intended to take from a victim. Indeed, the "opportunity cost" interest the courts are at pains to distinguish from promised interest comes closer to being a "loss" that can be causally related to the defendant's conduct than does a loss calculation based on pie-in-the-sky promises the defendant never intended to fulfill.

Whether to include interest in the calculation of loss is one of the more vexing problems in redrafting the economic crime guidelines.

If causation is to be the sine qua non of a new definition of loss, then it would seem that there could hardly be a clearer case both of causein-fact and foreseeability than a fraud victim's deprivation of the time value of the money purloined by the defendant. If an elderly couple gives their retirement savings to a confidence man instead of leaving those savings invested in government bonds, the defendant has plainly caused the couple to lose not only their principal but the return they would have earned had they never met the defendant. In such a case, the defendant's conduct was inescapably the cause-in-fact of the loss of accrued interest, and the loss of that accrual was easily foreseeable. And yet, it is hard to say what the victims would have done had they not been victims. Perhaps they would have lost all the money, principal and potential interest, at the nearest gaming emporium. Perhaps they would have stuck it under the mattress, keeping the principal but foregoing the interest.

The rule proposed here takes a middle position. It adopts, with some modifications, the "bargained-for interest" exception created by the courts of appeals to the Guidelines' current "no interest ever" rule. Under the

new rule, interest will be included in loss if a victim relied on a promise to pay a return on investment in deciding to part with his money or property. This result is justifiable, not because we are giving the victims the benefit of a criminal bargain, but because the fact that the victims' bargained for return on investment is proof that they would have sought some other legal avenue of investment, and thus that there is a genuine causal link between the defendant's conduct and the victim's deprivation of opportunity cost interest.

However, under the proposed rule, the amount of interest included in the loss figure would be calculated, not by reference to the defendant's promises, but by reference to the same statutory rates applied to damages awards in civil cases.30 There are several reasons for taking this approach. First, the opportunity cost component of loss would, and should, remain constant from case to case and defendant to defendant. There is no sound reason for punishing a defendant who commits a $ 10,000 credit card fraud against an issuer that charges twenty-one percent interest more severely than a defendant who defrauds a different issuer of the same amount simply because the second issuer happens to charge the more reasonable interest rate of fourteen percent. Similarly, it makes no sense to sentence two con men differently because one makes more outlandish promises of improbable profits than the other. Second, use of a standard interest rate simplifies the fact-finding process in two ways: (1) by eliminating the need to determine precisely what the promised rate of return was; and (2) by eliminating the even more troublesome issue of whether any particular promised rate of return was commercially reasonable.

C. Loss and the Problem of Measurement

As noted above, the two basic definitional problems inherent in a scheme to rank economic crimes by measuring economic harm are the problem of inclusion and the problem of measurement.41 I have argued in the preceding section that the problem of inclusion is best addressed by defining loss in terms of cause-in-fact and foreseeability.

Even under this approach, a number of critical problems of measurement remain, in particular the question of when loss should be measured, and the question of net versus gross loss.

1. When Should Loss Be Measured?

The current Guidelines do not specify when actual loss should be measured.2 The word "actual"3 implies that courts are to measure the real economic harm to victims that resulted in fact from a defendant's conduct. But, the result of that measurement may be different depending upon when the measurement is taken. There are at least four different points at which the measurement could be made: (1) the point at which the crime is legally complete, i.e., when there has been a confluence of culpable mental state and actus reus on the part of the defendant sufficient to render him criminally liable; (2) the point at which the crime is discovered; (3) the sentencing date; or (4) the point at which all the economic consequences of the defendant's conduct have become final (for example, when civil lawsuits for damages or recovery of property have been concluded).3

A simple illustration may be helpful. If A breaks the window of my car and steals it, but is apprehended pulling out of my driveway, the "actual loss" to me in real economic terms may differ depending on when I measure it. At the moment A assumes control over the vehicle and begins pulling away, my loss is the fair market value of the car because I have lost control over the whole asset. At the moment of A's apprehension, my only loss is the damage to the window, because I have the car but must spend money to repair it. By the time of A's sentencing, I may have suffered no measurable economic loss at all if my insurance company has reimbursed me for the window.345 After sentencing, again I may have sustained no real loss if A makes restitution or my insurance company reimburses me for the window.

Language in the Guidelines or in the cases provides some support for all four options.6 a. Time of the Crime Application Note 2 to the theft guideline provides two exampies that lend support to the use of the time of the crime as the point at which loss should be measured.347 Example 1 says that in the case of theft of a check or money order, the loss is the value of the stolen instrument regardless of whether the check was cashed. Example 2 is the case discussed above of the stolen car *recovered immediately."

The commentary says that the loss is the value of the vehicle despite its prompt recovery, a result explainable only if the loss measurement is taken immediately after the legal completion of the theft.

Two, or perhaps three, courts of appeal have implicitly adopted a "time of the crime" rule.? b. Time of Detection

Application Note 7(b) to the fraud guideline says that the loss in a fraudulent loan case is "the amount of the loan not repaid at the time the offense is discovered."349 The guideline does not address the question of discovery by whom: Is it sufficient that the victim or the authorities discover the crime, or must the defendant be aware that it has been discovered?350 That question is largely unresolved, but at least seven circuits have written opinions stating that loss should be measured at the time of detection of the crime.351

c. Time of Sentencing

The Third and the Seventh Circuits have said that loss should be measured at the time of sentencing.32

d. Time of Final Resolution of All Claims

While it might seem impractical to suggest that courts should or would attempt to measure loss by taking into account events that have not occurred by the time of sentencing, in fact, the Guidelines attempt in certain respects to do just that. For example, Application Note 7(b) to the fraud guideline states:

In fraudulent loan application cases and contract procurement cases, the loss is the actual loss to the victim (or if the loss has not yet come about, the expected loss). For example, if a defendant fraudulently obtains a loan by misrepresenting the value of his assets, the loss is the amount of the loan not repaid at the time the offense is discovered, reduced by the amount the lending institution has recovered (or can expect to recover) from any assets pledged to secure the loan.353

The reference to "expected loss" is incompatible with the view that the amount of loss is fixed for sentencing purposes the moment a crime is complete. It suggests a bottom-line economic approach to loss. It clearly implies that the victim's loss cannot be tallied up until all claims have been resolved (or, at the least, until there has been a prediction about how they will be resolved) and there is a determination of how much economic harm the defendant ultimately will cause.?5

2. What Amounts Should Be Credited to a Defendant in Determining "Actual Loss"? The question of the point in time at which loss should be measured is often another way of asking whether a defendant should receive credit for money or things of value the victim received either during the course of the criminal transactions or thereafter. Among the common problems are:

(1) Whether a defendant should be given credit in the calculation of actual loss for anything of value he gives to victims in return for the money or property obtained by fraud.

(2) Whether a defendant should be given credit for amounts or assets pledged as collateral as part of a fraudulently induced transaction.

(3) Whether a defendant should be given credit for repayments made after the completion of the theft or fraud, but before detection of the crime.

(4) Whether a defendant should be given credit for repayments or recoveries made after discovery of the crime, but before sentencing.

The answers to the first and fourth questions have been both clear and uniform: Except for assets pledged by the defendant in a fraudulent loan setting, payments made by the defendant or recoveries of property occurring after discovery of the crime but before sentencing, are not credited to the defendant.355 Similarly, there is general agreement that a defendant is to be given credit for anything of value he transfers to a victim in return for the money or property obtained by fraud. For example, section 2F1.1, Application Note 7(a), provides that where a defendant misrepresents the value of an item, the loss is the difference between the item's actual value and the falsely represented value. The defendant is credited for any real value conveyed to the victim.356

The issue of deducting value received by the victim is also presented in government contracting cases where a bidder secures the contract by lying about his qualifications, financial stability, or some other material fact. In the leading case of United States v. Schneider, Judge Posner distinguished between the contractor who secures a valuable contract by misrepresenting some fact, but who nonetheless intends to perform the contract to the best of his ability, and the contractor who obtains the valuable concession or contract with no intention of performing ("he means to pocket the entire contract price without rendering any service in return").357 Although the focus of the opinion is on intended loss where the misrepresentation has been discovered before the contract has been performed, its logic is arguably as applicable to cases in which the contract has been performed in whole or in part before discovery of the fraud, and where the government has thus received some benefit of its bargain.358

The Eleventh Circuit adopted an interesting modification of the Schneider approach in United States v. Orton.359 There the court calculated loss in a Ponzi scheme using what it characterized as a "loss to the losing victims" method.0 That is, the court added up all the losses to victims who actually suffered losses, but gave credit to the defendant for repayments made to early victims only to the extent of their original investment. The court did not credit the defendant for "interest" payments made to early victims above their original investment. The court stated: "(This method) does not reward a defendant who returns money in excess of an individual's initial 'investment' solely to entice additional investments and conceal the fraudulent conduct."361

The more difficult issues have concerned collateral and repayments made after completion of the crime, but before detection.

a. Credit for Assets Pledged as Collateral

The question of whether to credit the value of collateral against "loss" is closely related to the problem just discussed of whether things of value given to victims by defendants as an inducement or as part of the criminal scheme should be credited. The rule noted there (that credit should be given) is consistent with the specific rule expressed in Application Note 7(b) for cases of fraudulent loan applications, namely that the value of "assets pledged to secure the loan" should be deducted from the loss.362 The distinction between the two situations is that the first concerns a transfer by the defendant of ownership or control of the thing of value, and the second concerns transfer by the defendant of a security interest that may be exercised only in the event of the defendant's default on his undertakings.

Despite the apparent clarity of Application Note 7(b), the circuits vary widely in interpreting it. Several circuits have held that a reduction of the loss figure by the value of the "assets pledged to secure the loan" is

discretionary with the district court.36 And although the majority of courts heed the plain implication of Note 7(b) that assets of a defendant not pledged to secure the loan should not be credited against the loss figure,364 one court has taken the position that unpledged assets should be, or at least may be, deducted from the "loss" calculation. In United States v. Wright, the defendant fraudulently obtained three loans.365 Two of the loans were secured by security interests in real property purchased with the loan proceeds; one of these was also secured by a right of set off against a deposit account held by the defendant at the lending bank. The third loan was secured by a fictitious deed of trust.36 After discovery of the fraud, the bank made good its losses on the first loan by foreclosing on the property and exercising the set-off against the deposit account.

On the second loan, the bank recovered most, but not all, of its money by foreclosure. As to the third loan, the defendant made additional arrangements to collateralize it after discovery of the fraud.367 The district court credited the defendant only with the amounts recovered from the sale of the real property pledged as loan collateral.

The Sixth Circuit reversed, holding that the set off against the deposit account on the first loan, the post-discovery repayment of the deficiency on the second loan, and the subsequent recollateralization of the third loan could all be credited against the loss.3 The court ignored section 2F1.1, Application Note 7(b),369 and concluded: "'Loss' should not include amounts that a bank can and does easily recover by foreclosure, set off, attachment, simple demand for payment, immediate recovery from the actual debtor and other similar legal remedies, including the sale of a 'pledged' asset covered by the example."370 In short, Wright held that a defendant can buy his way out of a portion of his prison sentence by making post-discovery restitution.371

The Sixth Circuit has since limited the holding in Wright, but in the course of doing so it created still more confusion. In United States v. Lucas, the court held that "application of Wright to simple demands for payment is too much at odds with the text of Application Note 7(b) to be accepted."372 Thus, if a bank discovers a fraud and demands repayment from the defendant and gets it, that repayment apparently will not be credited against loss. However, the Lucas court insisted that Wright survives in cases where the defendant's fraud assisted a third party to get a loan; in such a case, repayments by the third party after discovery (and even expected repayments) may be credited against loss.373 This result seems contrary to the plain wording of Application Note 7(b), to the relevant conduct policy of section lB1.3 mandating inclusion of harms resulting from the foreseeable acts of one's criminal partners,374 and to common sense.

Why should a defendant be credited for the post-discovery repayments made by his partners when he receives no credit for his own?

b. Credit for Pre-Detection Payments

Should a defendant be given credit for repayments made after the completion of the theft or fraud, but before detection of the crime? This question arises most commonly in two situations: (1) where the defendant's purpose was to misappropriate money or property for a limited time in order to invest it, to cover short-term cash flow problems, or the like; and (2) where the defendant repays money he originally intended to keep either out of guilt or a desire to avoid detection. The courts are divided in cases involving these situations.

In check-kiting cases, the general consensus is that loss is to be measured by determining the size of the overdraft at the time of discovery of the crime.375 Not all courts agree, however. The Eighth Circuit, for example, adopted a minority position in United States v. Morris.376 Morris was convicted of bank fraud, check-kiting, and making false statements to obtain a loan.377 During the course of the scheme, but before detection, the defendant arranged for the sum of $ 156,000 to be repaid to the bank to avoid detection by bank

regulators. At sentencing, the defendant asked for credit for this amount against the loss. The district court allowed the credit, but the court of appeals disagreed and refused the credit.378

Embezzlement cases also present the problem of whether to credit defendants for repayments made before detection. In United States v. Johnson, a credit union clerk "embezzled" $ 88,483 (by withdrawing funds from credit union accounts) and misapplied another $ 318,915 by transferring it to another account in the credit union, but not withdrawing it.379 She turned herself in before withdrawing the $ 318,915. The Eighth Circuit held that the loss included the embezzled $ 88,000, but not the misapplied $ 318,915.33* Likewise, in United States v. Shattuck, the First Circuit indicated in dicta that the amount of "victim loss" in an embezzlement does not include the amount of misapplied funds that remained in a bank account. 381

The Third and Seventh Circuits have taken a contrary position. In United States v. Strozier, the Seventh Circuit held that where the defendant fraudulently deposited $ 405,000 into a bank account, but withdrew only $ 36,000, the loss was $ 405,000.312 In United States v. Kopp, the Third Circuit discussed in dicta the situation of a hypothetical bank clerk who intends to withdraw the money, invest it, and then return it.383 The court noted that, while the "amount taken" would be the amount invested, if the clerk were successful and returned the money without detection, both the intended and actual loss would appear to be zero. The court appeared to view this result as unacceptable, and implied that the proper measure of loss would be the whole amount.334

3. Proposed Application Notes Regarding Time of Loss and Net Loss

The consolidated economic crimes guideline should adopt the following application notes containing rules for determining the time at which loss is to be measured, and defining net loss:

Application Notes fcont. 7 ff)Time of measurement of loss

Loss should ordinarily be measured at the time the crime is detected. However, if the loss was higher at the time the crime was legally complete, the loss should be measured at that time. Likewise, if a defendant continues to engage in criminal conduct that increases the loss after the crime is detected, the increased loss resulting from such post-detection conduct should also be included as loss.

For purposes of this guideline, a crime is detected when either a victim or a public law enforcement agency has (at least) a reasonable suspicion that a crime is being or has been committed and the defendant becomes aware that such suspicion exists. In many cases, the crime will be "detected" at the moment of a defendant's arrest. Examples: (i) In the case of a defendant apprehended in the act of taking a vehicle, the loss is the value of the vehicle even if the vehicle is recovered immediately. (ii) In the case of an embezzlement in which the defendant converts to his own use money from a bank to invest or to cover short-term cash flow problems and then returns it before being caught, the loss is the amount of money originally converted. (iii) In the case of a bank fraud involving a bank officer, the crime would be detected when defendant became aware that bank examiners were reviewing irregularities in the bank's books relating to the fraud, or that federal agents were interviewing witnesses or serving grand jury subpoenas relating to the fraud.

(g) Net loss

The loss shall be the net loss to the victim or victims. (i) The amount of the loss shall be reduced by the value of money or property transferred to the victim(s) by the defendant in the course of the offense. For example, where a defendant sells stock to the victim by fraudulently representing that the stock is worth $ 40,000 when it is worth only $ 10,000, the loss is the amount by which the stock was overvalued (i.e., $ 30,000).

However, where there is more than one victim, the loss will be the total of the net losses of the losing victims. For example, in a Ponzi scheme in which the defendant repays early victims their entire investment plus

a profit in order to keep the scheme going and. attract new investments and investors, the defendant should be credited for repayments to early victims only to the extent of their original investment, plus statutory interest in an amount determined by reference to Application Note 7(i).

(ii) The amount of the loss shall be reduced by the value of property pledged as collateral as part of a fraudulently induced transaction. Where a victim has foreclosed on or otherwise liquidated the pledged collateral before detection of the crime, the loss shall be reduced by the amount recovered in the foreclosure or liquidation. Where a victim had not foreclosed on its security interest in the pledged collateral at the time of detection of the crime, the loss shall be reduced by the fair market value of the pledged collateral at the time of detection.

(iii) With the exception of amounts recovered or readily recoverable by a victim through liquidation or foreclosure of collateral pledged by the defendant as a part of the illegal transaction(s) at issue in the case, the loss shall not be reduced by payments made by the defendant to a victim after detection of the crime. With the same exception, loss shall not be reduced by amounts recovered or readily recoverable by a victim from the defendant through civil process or similar means after detection of the crime.

4. Analysis of Proposed Application Notes on Time of

Measurement and Net Loss

a. When to Measure Loss From the four possible points at which loss could be measured-time-of-the-crime, time-of-detection, time-of-sentencing, and time-of-resolution of all victim claims-the proposed rule adopts a combination of time-of-the-crime and time-of-detection.

A pure time-of-the-crime rule would seemingly mesh nicely with general principles of criminal liability. Assuming the legislature has made it so, conduct becomes criminal, and thus punishable, once there has been a confluence of harm, causation, a prohibited act or omission, and a prohibited culpable mental state.335 If a thief is caught wheeling my car out of my driveway, the law deems him to have successfully stolen the whole car, notwithstanding that a policeman happens to foil his getaway. Moreover, regardless of the final outcome to the victim in economic terms, it makes intuitive sense to say that, at the moment of the theft, the victim has suffered an actual loss in the amount of the value of the car.

However, a pure time-of-the-crime rule would pose a number of practical problems. Primary among these is the fact that a crime is often legally complete before the full extent of the ultimate harm is inflicted. To take the simplest example, a conspiracy to rob a bank is legally complete once there has been an agreement to rob followed by an overt act by one of the conspirators,38 but the amount of the actual loss occasioned by the crime will not become clear until the conspirators secure the loot and leave the bank. Similarly, a fraud case may be federally prosecutable following the formation of a scheme to defraud, a single misrepresentation to a potential victim, and a single wiring or mailing,87 but the defendant's criminal conduct will continue and the victim's losses will continue to mount until the defendant shuts down the scam or gets caught.

A time-of-detection rule is presently employed by at least seven of the twelve circuits,38 and for most cases this rule makes the best sense. Once a crime is discovered by its victims, the victims can take steps to eliminate further losses. Because the rule defines "detection" to include an awareness of discovery by the defendant, defendants will ordinarily stop their criminal behavior at detection, either because they have been arrested or because they fear arrest and do not wish to make their punishment worse. Thus, in the ordinary case, the time of detection will be the point of maximum loss. There are three exceptions to this generalization, all of which are accounted for in the proposed rule.

First, some criminals will pay back stolen money before detection out of guilt, remorse, or a desire to avoid getting caught. The charitable approach to such cases would be to give the defendant credit for the money repaid. The objections to such charity are: (1) By using the amount of money originally stolen as the measure of offense seriousness despite the payback, we account for the risk of loss the defendant originally imposed regardless of his good intentions; and (2) a pure time-of-detection rule in such cases would produce disparate sentences for defendants with identical intentions to repay based on the fortuity of when the authorities caught on to the scam. I find the objections compelling, as well as in line with existing precedent, and so have eschewed charity.[389]

Second, some obstinate offenders will continue to steal even after the jig is up and they know it. They should not be relieved of liability for defalcations occurring after detection.

Third, although in many cases loss will continue to accrue after detection despite the cessation of a defendant's active criminal efforts, measuring loss at the date of sentencing raises too great a potential for arbitrariness. If defendants were credited with repayments made after detection but before sentencing, the rich (or those who simply had not yet spent the swag) could buy themselves out of prison time.[390] And from the defendants' point of view, they should not have to spend more time in prison because losses mounted while the government or court delayed prosecution or sentencing.

b. Net Loss

The net loss rules proposed here are generally in accordance with existing Guidelines language and with the majority positions of courts that have dealt with the subject. The proposed rules do adopt one minority position, the "loss to the losing victims" approach to multiple victim frauds sanctioned in United States v. Orton.[391] The opposing view, that scam artists should receive no credit whatever for money paid to maintain investor confidence and prolong the fraud, is understandable.[392] Nonetheless, if "loss" is indeed to be net loss, it is difficult to draw a principled distinction between payments to Ponzi scheme investors and other benefits conferred on fraud victims that are incontestably deductible from loss, such as undervalued stock or real estate pledged as collateral for a loan. The "loss to the losing victims" approach provides an attractive compromise between crediting a defendant for no Ponzi repayments, and thus overstating the degree of economic harm inflicted, and crediting a defendant with all repayments including overpayments to early investors, a result that ignores the fact that economic losses are experienced individually and that the undeserved bonanzas of early investors are no balm for the uncompensated losses of those victimized after the well runs dry.

The proposed rules also emphasize that assets pledged as collateral as part of the inducement in fraudulent loan cases are to be deducted from "loss." The principal change proposed is in the time at which the collateral is to be valued. Consistent with the approach to time of measurement explained in the previous section, the collateral is to be valued at its sale price if sold before discovery of the crime, or if not sold, at its fair market value at the time of detection. This approach continues to penalize the defendant for decreases in collateral value regardless of the reason for the decrease; however, it shortens the period within which such decreases might conceivably occur by excluding devaluations between detection and sentencing.

This approach is a compromise. Where a defendant offers collateral, he ought to receive credit for its value against loss. By the same token, when a defendant fraudulently induces a victim to enter into a transaction, even a collateralized one, it does not seem unreasonable to penalize him when investment risks to which he exposed the victim are realized in the form of a drop in collateral value. However, once the crime is detected, the victim is at liberty to liquidate the collateral or take other steps in mitigation. A defendant should not suffer for a victim's lassitude, or be exposed to the risk of market declines for periods dependent on prosecutorial efficiency, the condition of court calendars, or other factors unrelated to culpability.

V. "INTENDED LOSS" SHOULD REMAIN A COMPONENT OF FEDERAL ECONOMIC CRIMES SENTENCING

A. The Rationale for Sentencing Based on 'Intended Loss"

The preceding Part was devoted to defining and measuring the actual losses inflicted by defendants. We now turn to "intended loss." The present fraud guideline provides that where the loss a defendant intended to inflict was larger than the loss the victim actually sustained, the larger intended loss figure should be used to calculate the sentence.393 Moreover, a good many courts have held the same rule applicable to theft crimes, despite the absence of language in section 2B1.1 applying the intended loss rule generally to such cases.39 Before addressing the interpretational problems posed by the current intended loss provisions, however, it may be useful first to consider the place of intended loss in the overall scheme of sentencing economic crime.

A measurement of actual loss caused by a defendant's criminal conduct is an appropriate component of the sentencing calculation because, as noted above, it measures actual harm and serves as a proxy measurement for other offense seriousness factors like state of mind. By contrast, "intended loss," because it is only used when it exceeds actual loss, measures harms that never happened. Therefore, if intended loss is to be included in a revised and consolidated economic crime guideline, it must serve a different purpose than "actual loss."

In fact, it serves two. The Sentencing Commission provided an increase in offense level for "intended loss" for the same reasons that substantive criminal liability is imposed for inchoate crimes like attempt and conspiracy.395 The connection between "intended loss" and inchoate criminality is manifest in the language of section 2F1.1, which says, "Consistent with the provisions of section 2X1.1 (Attempt, Solicitation or Conspiracy), if an intended loss that the defendant was attempting to inflict can be determined, this figure will be used... ."396 The Commission was certainly correct to include "intended loss" in the sentencing mix. First, criminal law is preeminently concerned with blameworthiness.397 While the occurrence of harmful results is ordinarily a prerequisite for criminal liability, to some degree punishment on that basis has more to do with luck than just deserts. Would-be killers who shoot straight are punished for murder while those who aim badly are not. Nonetheless, we punish unconsummated efforts to cause harm as "attempts" or "conspiracies" (albeit usually less severely than completed crimes) so long as the would-be perpetrator has come close enough to success that we can be confident his malignant designs were real and not mere fantasy, and thus that his conduct was morally blameworthy.398 Second, we punish the unsuccessful criminal, not only because he deserves it, but because his frustrated plans present a high enough risk of actual harm that punishment for the purpose of deterrence is warranted.

The idea of basing punishment for economic crime on intended loss is grounded in the same moral and utilitarian considerations that support imposing substantive liability for attempts and conspiracies.

Morally, we may consider that a swindler who intends to take a large amount of money is more culpable, and thus deserves a greater punishment, than one who seeks or secures a smaller amount.3? From a utilitarian perspective, use of intended loss in the sentencing calculus imposes consequences (and thus, one hopes, achieves a deterrent effect) proportionate to the degree of risk the defendant's behavior posed to the economic well-being of his fellow citizens, as measured by the magnitude of his criminal objectives.

B. What Is Meant by Intended Loss?

In "intended loss" cases, most courts say they look to the defendant's subjective intent,4 rather than presuming the defendant to intend all the natural and probable consequences of his acts.401 The provision of section 2F1.1 concerning intended loss seems to have been primarily directed at situations in which a defendant

is seeking to defraud victims of a large amount, but is forestalled from doing so by arrest, discovery of the scheme, or other happenstance, and actually obtains less than he had planned. Despite the fact that the "intended loss" component of section 2F1.1 may have been primarily directed at expanding the scope of sentencing liability for enterprising but unsuccessful crooks, it has frequently been the basis of arguments for reducing loss calculations. For example, in United States v. Schneider, Judge Posner distinguished between the contractor who lies to get a contract but intends to perform it and the "true con artist" who "means to pocket the entire contract price without rendering any service in return."402 In other cases, defendants have successfully argued that loss should be reduced if they could establish a subjective intention to repay the victim.403

The Ninth Circuit has rejected an analogous argument. United States v. Yellowe concerned a credit card fraud in which the defendant tried unsuccessfully to use credit card numbers to make unauthorized charges.4 The defendant argued that, because section 2F1.1 mandated the use of the greater of either "actual loss" or "intended loss," and because there was no actual loss, then the measure of intended loss should focus on the defendant's subjective expectations about the loss amount. He claimed he only expected 12.6% of the card numbers to be valid and thus he should be accountable only for those. The district and appellate courts rejected his argument and held him responsible for the minimum $ 100 per card specified in section 2B1.1, Application Note 4.405

C. Must the Defendant's Intentions Be Realistic?

Should a defendant be held responsible for losses he intended to inflict even if the achievement of his criminal goals was impossible or highly improbable? This issue arises in two types of cases-those involving government "sting" operations where no loss was possible because the defendant was dealing with government agents, and those in which the defendant's objectives were either impossible or improbable for some other, usually economic, reason. There is a divergence of views among the circuits on both types of case.

1. Sting Operations

Defendants caught by government undercover operations before they can steal any money commonly argue that the intended loss provision of section 2F1.1, Application Note 7, should not apply to them because no actual loss was possible. The majority of the circuits to have addressed the question reject this argument and treat fraud cases no differently than drug cases or other stings in which success is foreclosed by the defendant's choice of confederate?

The Tenth Circuit, however, has taken a different view. In United States v. Galbraith, the court held that where the defendant is dealing with a government agent and no money changes hands, there is no loss.407 The court reasoned that, because loss is supposed to measure economic harm, the loss is zero in a situation where no harm could have occurred. The court's rationale for ignoring the fraud guideline's directive to use "intended loss" merits some scrutiny.

The Galbraith court relied heavily on United States v. Santiago.48 In Santiago, the defendant falsely reported to his insurance company that his car had been stolen and submitted a claim for $ 11,000. Because the police intervened, the claim was not processed; had it been, the insurance company would have paid at a maximum the car's "blue book" value of $ 4,SOO.409 The court concluded that the "intended loss" could not "exceed the loss a defendant in fact could have occasioned if his or her fraud had been entirely successful," in this case $ 4,800.41

Santiago does not compel the result in Galbraith. Indeed, literal application of the Santiago standard to the facts of Galbraith produces a result contrary to the one reached by the court. If Galbraith's "fraud had been

entirely successful," he would have secured over $ 600,000.41, To say that Galbraith "could not have succeeded" because he was dealing with government agents is the same as saying that Santiago "could not have succeeded" because the police discovered his scam before the claim could be processed.

The Tenth Circuit is apparently attempting to import into fraud sentencing some version of the criminal liability doctrines of mistake of fact or impossible attempts. Although, as will be suggested below,412 these principles have a place in sentencing law, the Tenth Circuit does not appear to have applied them properly to the facts of Santiago. A defendant claims mistake of fact when he wishes to establish that he lacked the requisite culpable mental state necessary to establish criminal liability. The claim will be effective only where the mistaken belief, if honestly held, would disprove the existence of the required mental state.413 Modern law concerning the doctrine of impossible attempts looks at the facts as the defendant believed them to be. If he did everything he could do to complete the transaction or performed a substantial step toward completion, and the completed transaction would have constituted a crime if the facts were as he thought them, he is guilty of attempt.414

If Santiago honestly believed that his insurance claim could yield $ 11,000, he was certainly guilty of at least an attempt to defraud the company of $ 11,000. At a minimum, and as the Santiago court held, his overly optimistic goals certainly should not relieve him of liability for the $ 4,800 loss that would have occurred without the vigilance of the police. Likewise, the question in Galbraith is whether, if the facts were as Galbraith believed them to be, he could have succeeded in defrauding his putative victims of over $ 600,000. The answer is plainly yes.415

In the end, Galbraith's interpretation of section 2F1.1, Application Note 7, is not compelling, and seems to be foreclosed by Application Note 10. Note 10 authorizes a departure "where a defendant attempted to negotiate an instrument that was so obviously fraudulent that no one would seriously consider honoring it."416 As the D.C. Circuit observed in rejecting Galbraith's analysis: "It would be unnecessary to authorize such a departure if the unlikelihood of success already limited the intended loss attributable to a defendant under application note 7."417

2. Impossibility or Improbability

In Galbraith, the Tenth Circuit also relied on the Sixth Circuit's opinion in United States v. Watkins4ls and its own work in United States v. Smith,419 where it held that to meet the requirements of section 2F1.1, "the record must support by a preponderance of the evidence the conclusion that Mr. Smith realistically intended a $ 440,896 loss, or that a loss in that amount was probable."420 Watkins and Smith are exemplars of a line of cases that attempt to impose an outer limit on the scope of intended loss by reference to some notion of economic reality.421 Some of the early cases in this line, including Smith, seem to have drawn inspiration from the reference to "probable" loss in the pre-1991 guidelines,422 a term which has since been omitted.423 Nonetheless, even since that amendment, some courts have continued to consider the probability of success of defendants' schemes.424

A particularly interesting example of this phenomenon is Judge Easterbrook's opinion for the Seventh Circuit in United States v. Sung.425 At the time of his apprehension in this product counterfeiting case, the defendant had actual sales of no more that $ 70,400, but had obtained counterfeit cartons that could have held products worth $ 960,000.426 He was convicted of violating 18 U.S.C. 2320(a), which provides, "Whoever intentionally traffics or attempts to traffic in goods or services and knowingly uses a counterfeit mark on or in connection with such goods or services' commits a crime."427 The district court found a loss in the amount of $

960,000.428 On appeal, the circuit court found the defendant responsible for only $ 70,400 and remanded for resentencing.429

The court apparently imposed a test requiring the sentencing court to consider the reasonableness or feasibility of the defendant's criminal intentions. Referring to section 2X1.1 regarding attempts, it asked whether the defendant had any "reasonable expectation of being able to sell" $ 960,000 worth of counterfeit hair products.430 The court went on to say: "It is not clear to us that 'but for apprehension' Kim had any hope of reaping a million dollars from counterfeit hair products... ."431 The effect of this language in Sung is unclear because a year later, in United States u. Coffman, the Seventh Circuit expressly rejected the argument "that a loss that cannot possibly occur cannot be intended."432

The current majority position on this issue, adopted to date by the Second, Fifth, Ninth, Eleventh, and D.C. Circuits, is that the "amount of loss that the (defendants) intended to inflict does not have to be realistic."433

D. The Cross-Reference to the Attempt Guideline, Section 2X1. 1

The application note in the fraud guideline that creates the "intended loss" rule states that "(c)onsistent with the provisions of section 2X1.1 (Attempt, Solicitation and Conspiracy)," intended loss will be used where greater than actual loss.43 While, as noted above,435 the "intended loss" provision of section 2F1.1 exists for the same theoretical reasons that inchoate crimes exist, the cross-reference has created no end of confusion in practice. One source of the difficulty is the fact that section 2X1.1 gives a three-offense-level discount for uncompleted conduct. Not surprisingly, defendants have argued that any offense level produced by plugging an intended loss figure into the fraud loss table should be reduced by three levels.436

There are two views on this question. The Sixth Circuit has suggested that a court can determine intended loss under section 2F1.1 only by applying the attempt guidelines of section 2X1.1(b)(1).437 The Seventh Circuit has rejected this interpretation, holding that section 2X1.1 comes into play only in the case of uncompleted crimes, and not where the crime is legally complete but some component of the intended loss was not successfully inflicted.438 The distinction is intellectually tenable, but immensely difficult to apply in practice.439

E. Proposed Commentary on 'intended Loss" The Sentencing Commission should retain the "intended loss" concept, delete the cross-reference to section 2X1.1, and redraft the provisions of the application note concerning intended loss substantially as follows:

Apllcp.Notes (cont.) 8. If the defendant intended to cause a loss greater than the actual loss calculated pursuant to Application Note 7, the figure for intended loss shall be used as the *loss" in subsection (b)(1). a) Factual Impossibility

The defendant is accountable for all pecuniary harms he intended and which might reasonably have occurred if the facts were as he believed them to be.

b) Sting* Operations Intended loss includes pecuniary harms the defendant intended to cause, even if accomplishment of defendant's goals would have been unlikely or impossible because of the participation of an informant or undercover government agent.

F. Analysis of Proposed Guideline Commentary on 'Intended Loss"

Because application of the Guidelines requires a method for ranking the seriousness of particular instances of crimes of the same general type, intended loss or something very like it is indispensable. There must be a way of distinguishing among inchoate (and partially successful) economic crimes. Laws penalizing inchoate crimes

exist because such conduct is blameworthy and because it poses a risk of actual harm. Because inchoate and partially successful economic crimes are wholly or partially unconsummated efforts to inflict pecuniary loss, we should rank such crimes according to the amount of harm the defendant desired to inflict.4? A crook who sets out to steal a million dollars is, all else being equal, both morally more culpable and a greater social risk than one whose more modest goal is to snitch a pack of cigarettes.

Although blameworthiness and risk of harm are both important considerations in punishing uncompleted conduct, blameworthiness is the more significant factor. Therefore, just as in the guilt phase of a criminal trial, at sentencing the factual impossibility or improbability of success of a criminal plan should be no defense. The proposed application note focuses on the defendant's state of mind, on what he intended and what he believed. It holds him responsible for losses he intended, so long as they "might reasonably have occurred if the facts were as he believed them to be." The goal is to hold defendants responsible for their evil objectives, while taking account of risk of harm by leaving open the possibility of subtracting from loss those rare harms that simply could never have befallen even if things were as the defendant thought them.

It might be argued that there should be a discount for unrealized but intended losses as compared to loss actually inflicted. The consolidated guideline proposed here provides for such a discount, but it requires a moment's thought to see it. The proposed definition of actual loss expands the universe of pecuniary harms counted in loss to include reasonably foreseeable harms. Hence, where a criminal plan is successful, the perpetrator will be liable, not only for the harms he desires, but for such additional harms as are foreseeable to him. By contrast, the unsuccessful criminal is responsible only for the losses he desired to inflict; "foreseeability" does not enter the picture. Therefore, the cross-reference to the attempt guideline is unnecessary as well as confusing, and ought to be abandoned.

VI. CONCLUSION

I am a fan of the Federal Sentencing Guidelines. I think they are an improvement on the system they replaced and, in general, work far better than their many critics believe. Nonetheless, they remain an experiment. If the experiment is to succeed over the long term, the Guidelines and the Commission that shepherds them must be flexible and innovative enough to reinvent parts of the system that do not work well. The Guidelines' machinery for sentencing economic criminals is not broken, but it is unwieldy and inefficient; the gears are creaking, frustration is growing, and it is time for a new model. Whether the approach I have sketched out will be part of the blueprint for that new model remains to be seen. At the least, I hope it provides a place to start.

AFTERWORD

The U.S. Sentencing Commission met on April 7, 1998 to consider a package of proposals which would have consolidated the theft and fraud guidelines and redefined "loss" along the lines very close to those proposed here. The Commission, which at the time of the meeting had three of its seven seats vacant, was unable to come to a consensus on the entire package. It approved a two-level enhancement for sophisticated means similar to that advocated above,441 but left completion of the work of simplifying economic crime sentencing to the next group of Commissioners and the 1998-99 amendment cycle.

(Table Omitted)

Captioned as: APPENDIX A

(Table Omitted)

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(Table Omitted)

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Footnote:

1. As described below in more detail, sentence length for both theft-like and fraud-like crimes is determined largely by reference to "loss tables" appearing at U.S. SENTENCING GUIDELINES MANUAL 2Bl.l(bNl) (1997) (Theft) and 2F1.l(b)(1) (Fraud) (hereinafter USSG). See infra notes 110-32 and accompanying text.

2. An informal computer search of the Westlaw database for all federal appellate cases (excluding the U.Ss Supreme Court), conducted on August 15, 1997, revealed that the concept of "loss" in either USSG section 2B1.1 or section 2F1.1 was discussed in 894 federal appellate on-inions datinu from November 1987 to August 1997 (search result on file with author).

Footnote:

3. Describing each of these circuit splits in detail would consume more space than appropriate for a footnote. Among those discussed in this Article are differences of opinion over: (1) whether "loss" is to be defined differently in theft and fraud cases, see infra notes 148-71 and accompanying text; (2) whether "loss" can ever include so-called "consequential damages," see infra notes 248-50 and accompanying text; (3) what "consequential damages" means in the loss context, see infra notes 251-81 and accompanying text; (4) whether lost interest should be included in "loss," see infra Part IV.B.2.f; (5) when zloss" should be measured, see infra notes 342-54, and accompanying text; (6) whether assets pledged as collateral must be credited against "loss,' see in.fra Part IV.C.2.a; (7) whether assets available to pay or paid as restitution but not pledged as collateral by a defendant should be deducted from "loss," see infra notes 36274 and accompanying text; (8) whether money repaid before detection of the crime should be deducted from "loss," see infra Part IV.C.2.b; (9) whether factual impossibility reduces "loss" to zero, see infra notes 406-10 and accompanying text; (10) whether a defendant's criminal intentions must have been realistic to be counted as "intended loss," see infra Part V.C.2; and (11) whether intended loss can only be calculated by applying the attempt guideline, section 2X1.1, see infra Part V.D.

Footnote:

4' See, e.g., United States v. Kaczmarski, 939 F. Supp. 1176, 1182 n.7 (E.D. Pa. 1996), af)fd, 114 F.3d 1173 (3d Cir. 1997) (Judge Dalzell referred with obvious exasperation to the task of "construing the vaporous word loss"). The Second Circuit has described loss more circumspectly as aa flexible, fact-driven concept.' United States v. Jacobs, 117 F.3d 82, 95 (2d Cir. 1997) (quoting United States v. Dickler, 64 F.3d 818, 825 (3d. Cir. 1995)).

Footnote:

5. The memorandum that resulted from my review was distilled into a request for comment on 12 particular issues published by the Sentencing Commission in January 1997. See Federal Register Notice BAC2210-4G, 62

Fed. Reg. 152, 171-74 (1997) (identifying as issues for comment: (1) changes in the loss tables of section 2B1.1 and section 2F1.1; (2) consolidation of section 2B1.1 and section 2F1.1; (3) standard of causation; (4) market value as measurement of loss; (5) consequential damages and administrative costs as components of loss; (6) inclusion of interest in loss; (7) credit for benefits received by victims against the loss amount; (8) diversion of government benefits; (9) whether pledged collateral should be credited against the loss amount; (10) gain as an alternative measure of loss; (11) intended loss; (12) risk of loss; and (13) loss amounts that over- or understate offense seriousness). This Article addresses all these issues except changes in the loss tables.

Footnote:

6. See infra note 172 and accompanying text.

7. The theft guideline, section 2B1.1, has been amended 13 times. See USSG App. C, amends. 7, 99-101, 303, 312, 317, 361, 364, 481, 482, and 512. The fraud guidelines have also been amended 13 times. See USSG App. C, amends. 30, 154-56, 303, 317, 364, 393, 470, 481, 482, and 513. In both cases, single amendments often effected multiple changes.

Footnote:

8. As is true of the current theft and fraud guidelines, many of the significant aspects of the proposed consolidated guideline appear in the application notes, rather than in the guideline text. For ease of reference, and unless otherwise specified, in this Article any reference to the proposed consolidated economic crimes guideline should be understood to embrace both the proposed guideline and the proposed application notes.

Footnote:

9. Witnesses at the October 15, 1997 hearing were Judge Gerald E. Rosen, on behalf of the Judicial Conference's Committee on Criminal Law, James E. Felman, on behalf of the Practitioners' Advisory Group, Gregory A. Hunt, on behalf of the Probation Officers' Advisory Group, and Frank O. Bowman, III. See 66 U.S.L.W. 2278 (Nov. 11, 1997) (summary of hearing testimony); 10 FED. SENTENCING REP. 157 (Nov.-DEC. 1997) (edited transcript of hearing). Written statements from the witnesses are available at <<httpJ/www.ussc.gov/hearings.htm>>, under "Hearing Transcripts and Testimony Regarding Sentencing Guideline Amendments."

Witnesses at the March 5, 1998, hearing included Katrina Pflaumer, U.S. Attorney; W.D. Washington; Mary Spearing, Chief, Fraud Section, U.S. Department of Justice; defense attorneys Mark Flanagan, David Axelrod, Gerald Goldstein, and Ephraim Margolin, as well as Frank O. Bowman, III. For a transcript of the hearing and written statements of the witnesses, see <<http://www.ussc.gov/hearings.htm>>. The hearing testimony is summarized in 8 Fed. Sentencing Guide, No. 24, at 1 (Roger W. Haines, Jr., and Jennifer Woll, eds. Mar. 30, 1998).

Footnote:

10. For a general discussion of the federal sentence reform movement that, in general, rejected the rehabilitative model of sentencing and produced the Federal Sentencing Guidelines, see Frank 0. Bowman, III, The Quality of Mercy Must Be Restrained, and Other Lessons in Learning to Love the Federal Sentencing Guidelines, 1996 WIS. L. REV. 679, 680-92; Stephen Breyer, The Federal Sentencing Guidelines and the Key Com.promises upon Which They Rest, 17 HOFST L. REV. 1 (1988); and Kate Stith 8D Steve Y. Koh, The Politics of Sentencing Reform: The Legislative History of the Federal Sentencing Guidelines, 28 WAKE FOREST L. REv. 223 (1993).

11. In the section of the Guidelines Manual headed 'The Basic Approach," the Sentencing Commission states:

Footnote:

A philosophical problem arose when the Commission attempted to reconcile the differing perceptions of the purposes of criminal punishment. Most observers of the criminal law agree that the ultimate aim of the law itself, and of punishment in particular, is the control of crime. Beyond this point, however, the consensus seems to break down. Some argue that appropriate punishment should be defined primarily on the basis of the principle of '*ust deserts.". . . Others argue that punishment should be imposed primarily on the basis of practical "crime control" considerations. This theory calls for sentences that most effectively lessen the likelihood of future crime, either by deterring others or incapacitating the defendant. Adherents of each of these points of view urged the Commission to choose between them and accord one primacy over the other. As a practical matter, this choice was unnecessary because in most sentencing decisions the application of either philosophy will produce the same or similar results. USSG ch. 1, pt. A(3) (1995).

Footnote:

12. See id.

13. Marc Miller, Purposes At Sentencing, 66 S. CAL. L. REV. 413, 463 (1992). 14. Professor Miller has proposed a gradualist approach to an increasing integration of purpose into the Guidelines sentencing process. He suggests that the Commission develop .purpose-based guidelines" which would encourage judges to begin the development of a .common law of purposes," upon which the Commission might then rely to develop more detailed purpose-based guidelines for particular offenses and offenders. Id. at 477-78. I confess to some skepticism that such a sophisticated feedback loop could be created or sustained between the judges and the Commission. The tone of Professor Miller's article suggests that he was sadly conscious even in 1992 that his proposals would require more of the participants in the federal sentencing system than they were likely to provide. See id. at 478-80.

15. "Take away that pudding-it has no theme." Attributed to Winston S. Churchill, in LORD HOME, WAY THE WIND BLOWS Ch. 16 (1976), quoted in, THE CONCISE OXFORD DICTIONARY OF QUOTATIONS 100 (Angela Partington, ed. 1994).

Footnote:

16. This approach derives in part from H.L.A Hart's distinction between the general justifying aim of punishment (which he considered to be crime control) and the rationale for allocation of punishments of differing severity among convicted offenders. See H.L.A. Hart, Prolegomenon to the Principles of Punishment, in PUNISHMENT AND RESPoNSIBILITY: ESSAYS IN THE PHILOSOPHY OF LAW 1 (1968). It owes a good deal to the work of Andrew von Hirsch and the members of the Committee for the Study of Incarceration reported in ANDREW VON HIRSCH, DOING JUSTICE: THE CHOICE OF PUNISHMENTS (1976). It is closely related to the approach described by Professor Ashworth of "declar(ing) a primary rationale (for punishment), and . . . provid(ing) that in certain types of case(s) one or another rationale might be given priority." ANDREW ASHWORTH, SENTENCING AND CRIMINAL JUSTICE 59 (1994). 17. See USSG ch. 1, pt. A(2) (1996).

Footnote:

18. Whether the Commission was correct that retributive and crime control approaches would produce equivalent outcomes in "most sentencing decisions," id. ch. 1, pt. A(3), is debatable. For example, one might

conclude that the moral seriousness of high volume drug trafficking crimes, as measured by the social harms they cause, is so great that very long sentences are "deserved" in all such cases. On the other hand, one might also conclude that the objective of crime control would be best served by imposing somewhat shorter sentences than have now become the norm in such cases. See Bowman, supra note 10, at 740-45.

19. The 'reprobative" or "expressive" function of punishment is described in VON HIRSCH, supra note 16, at 48-49, and sources cited therein. See also Bowman, supra note 10, at 742-43

Footnote:

(discussing the reprobative function of punishment in connection with drug offenses sentenced under the Guidelines).

20. The goal of rehabilitation, by contrast, does not necessarily dictate an invariable proportionality between severity of crime and severity of sentence. 21. See JEROME HALL, GENERAL PRINCIPLES OF CRIMINAL LAW 16-19, 185-90 (2d ed. 1960). 22. '(T)he assessment of harm caused by the defendant as a result of the crime charged has understandably been an important concern of the criminal law, both in determining the elements of the offense and in determining the appropriate punishment." Payne v. Tennessee, 501 U.S. 808, 819 (1991).

Footnote:

23. This analysis excludes the special case of capital murder where harms other than the decedent's death may be aggravating factors, proof of which is necessary for imposition of the death sentence. See id. at 820, 824-25; Gregg v. Georgia, 428 U.S. 153, 194-95 (1976).

24. See infra notes 173-74 and accompanying text (discussing the multiple functions of the loss measurement).

25. For example, if A, by pure inadvertence unattended by negligence, acts and sets in train a sequence of events that causes B's death, we say the harm to B that indisputably resulted from A's conduct is "not A's fault.' Similarly, if A passionately desires to kill B and lays a deadly snare, but B dies in a motor accident before reaching the trap, we also say that B's death is "not A's fault." In the first case, we really mean that, despite the fact that A's act caused B's death, no fault or blame attaches to A because he lacked a guilty mind. In the second case, we mean that, despite A's guilty mind, his actions did not cause the death.

Footnote:

26. See M'Naghten's Case, 8 Eng. Rep. 718 (1843) (holding defendant not criminally responsible if insane).

27. See WAYNE R. LAFAVE & AUSTIN W. SCOTT, JR., CRIMINAL LAw 4.7, at 368-76 (2d ed. 1986) (noting that diminished capacity can exonerate a defendant from criminal responsibility in some jurisdictions where defendant's mental condition is admissible as to all types and grades of offenses on the question of whether the defendant had the mental state that is an element of the crime charged, but may only mitigate the seriousness of the offense of conviction in other jurisdictions where defendant's mental condition is admissible only as to certain more serious offenses).

28. See id. at 387-92 (noting that voluntary intoxication is often permitted as a defense to negate so-called "specific" culpable mental states requiring knowledge or intent, but not the "general" mental states of negligence or recklessness required of lesser grades of the same crime).

Footnote:

29. See Bowman, supra note 10, at 684-85 (discussing individualized sentencing before the Guidelines); id. at 707-14 (discussing permissible uses of individualizing factors under the Guidelines).

30. For a stimulating critique of the idea that sentences should be based primarily on offense seriousness, see Russell M. Coombs, Perfecting a Blunder: Redefining Loss as the Main Gauge of Federal Sentences for Theft and Fraud, 10 FED. SENTENCING REP. 152 (Nov.-Dec. 1997) (arguing that to maximize crime control, sentences should be based primarily on offender characteristics).

31. See USSG ch. 5, pt. A.

Footnote:

32. See id. By statute, the top end of the range can be no more than 25% higher than the bottom end. For discussion of the "25% rule," see Bowman, supra note 10, at 691 n.49, 712-13. 33. See USSG chapter 4 for the rules regarding calculation of criminal history category. 34. See USSG APP. A (Statutory Index).

Footnote:

35. See id. 2BLl(b)(1) (reflecting an increase in offense level of 2 for a theft of more than $ 1,000 and increase of 13 for a theft of more than $ 800,000).

36. See id. 2B3.1(bx3) (reflecting possible increases of up to 11 offense levels for the use of a weapon and causing injuries in the course of a robbery).

Footnote:

37. See id. 3B1.1 (the defendant's offense level can be enhanced by either 2, 3, or 4 levels depending on the degree of control he exercised over the criminal enterprise and on the size of that enterprise).

38. See id. 3C1.1, application note 3 (obstruction of justice includes conduct such as threatening witnesses, suborning perjury, producing false exculpatory documents, destroying evidence, and failing to appear as ordered for trial). 39. See id. 3A1.2.

Footnote:

40. See id. 3A1.1 (creating an enhancement where a victim was selected on the basis of "race, color, religion, national origin, ethnicity, gender, disability, or sexual orientation" and in the case of a victim "unusually vulnerable due to age, (or) physical or mental condition"). 41. See id. ch. 3, pt. D.

42. See id. 3B1.2 (allowing 2 or 4 level decreases in offense level if defendant found to be a "minor participant" or "minimal participant" in the criminal activity).

43. Id. 3E1.1 (allowing reduction of 2 offense levels where defendant "clearly demonstrates acceptance of responsibility," and an additional offense level if otherwise applicable offense level is a least 16 and defendant has "assisted authorities in the investigation or prosecution of his own misconduct" by taking certain steps). Despite the euphemism "acceptance of responsibility" section 3E1.1 is simply an institutionalized incentive for guilty pleas.

Footnote:

44. See id. 5C1.1(a) (stating that '(a) sentence conforms with the guidelines for imprisonment if it is within the minimum and maximum terms of the applicable guideline range"). 45. See 18 U.S.C. 3553(b) (1994); USSG 5K2.0.

Footnote:

46. Chapter 5, Part H of the Guidelines lists factors that the Commission determined to be .not ordinarily relevant to the determination of whether a sentence should be outside the applicable guideline range.' USSG ch. 5, pt. H commentary. These include age, see id. 5H1.1 (1995), educational and vocational skills, see id. 5H1.2, mental and emotional conditions, see id. 5H1.3, physical condition, see id. 5H1.4, history of substance abuse, see id. 5H1.4, employment record, see id. 5H1.5, family or community ties, see id. 5H1.6, socioeconomic status, see id. 5H1.10, military record, see id. 5H1.11, history of charitable good works, see id., and atl)ack of guidance as a youth," id. 5H1.12. In theory, most of these factors nonetheless can justify a departure, but such a departure is permissible only where the excluded factor is present to a degree so unusual that the Commission would not have anticipated its impact and thus did not "adequately (take it) into consideration," 18 U.S.C. 3553(b), when formulating the guidelines.

Footnote:

47. The term "relevant conduct" and its applications to guideline calculations are enumerated in USSG lB1.3. For a general discussion of relevant conduct and its function in the guidelines system, see William W. Wilkins Jr. Sc John R. Steer, Relevant Conduct: The Cornerstone of the Federal Sentencing Guidelines, 41 S.C. L. REV. 495 (1990); see also Bowman, supra note 10, at 702-03.

48. See, e.g., Daniel J. Sears, Defense Practice Under the Bail Reform Act and the Sentencing Guidelines-A Shifting Focus, FED. PROBATION, Dec. 1991, at 38, 40 (categorizing the sentencing process under the Guidelines as a process based on " 'real offense' behavior rather than the offense of conviction"). But see Jeffrey Standen, Plea Bargaining in the Shadow of the Guidelines, 81 CAL. L. REV. 1471, 1505-12 (1993) (asserting that the Guidelines are actually a charged offense system).

Footnote:

49. First degree murder generally involves both an intentional killing and some form of premeditation. See, e.g., COLO. REV. STAT. 18-3-102(1)(a) (1997). Second degree murder, where it exists, is usually either a "knowing" killing, see, e.g., id. 18-3-103(1), or one carried out purposefully, but without premeditation, see, e.g., WASH. REV. CODE 9A.32.050(1Ha) (1995). Manslaughter is usually of two types, voluntary, which customarily denotes some form of "heat of passion, see, e.g., VA. CODE ANN. 18.2-35 (1995); MODEL PENAL CODE 210.3(1)(b) (1980), or involuntary, which usually means "reckless," see, e.g., VA. CODE ANN. 18.2-36 (1995); MODEL PENAL CODE 210.3(1Xa) (1980). Many states also have some form of criminally negligent homicide. See, e.g., COLO. REV. STAT. 18-3-105 (1997); WASH. REV. CODE ANN. 9A.32.070 (West Supp. 1997-1998) (defining manslaughter in the second degree as causing the death of another person "with criminal negligence"). In states with the death penalty, the state is required to prove the highest form of culpable homicide plus one or more aggravating factors. See, e.g, COLO. REV. STAT. 16-11-103 (1997).

Footnote:

50. See, e.g., WASH. REv. CODE ANN. 9A.36.011 (West Supp. 1997-1998) (first degree assault committed where defendant "with intent to inflict great bodily harm" assaults victim with deadly weapon, administers poison, or inflicts great bodily harm); id. 9A.36.021 (defining second degree assault as assault committed where defendant administers poison with intent to inflict bodily harm, inflicts substantial bodily harm, or assaults victim with a deadly weapon); id. 9A36.030 (defining third degree assault as involving less harm and less dangerous weapons than required in first and second degree assaults). Because the presence or dangerousness of a weapon is considered to demonstrate a willingness to inflict the sort of harm that can be caused by dangerous or deadly weapons, it functions as a proxy for measuring blameworthiness.

51. See, e.g., ROLLIN M. PERKINS Bc RONALD M. BOYCE, CRIMINAL LAw 290 (3d ed. 1982) (*Under the early law felonies were punishable by death, and larceny was a common law felony."). Professor Roger Groot, one of the leading authorities on 12th and 13th century English criminal practice, see, e.g., Roger D. Groot, The Jury of Presentment Before 1215, 26 AM. J. LEGAL HIST. 1 (1982), tells me that his study of English plea rolls from the thirteenth century

Footnote:

reveals a de facto division of larceny cases into offenses meriting hanging and those that did not, predating the formal creation of grand and petit larceny categories in the Statute of Westminster of 1275. Professor Groot says that, as early as the 1240s, defendants often were not subjected to the normal criminal process when they stole *petty things." Telephone Interview with Roger D. Groot (October 1997). 52. See PERKINS & BOYCE, supra note 51, at 335 nn.4 & 5. 53. See 30 Geo. II, c. 24, 1 (1757), reprinted in 8 UK Stat. 73 (1948). 54. See 39 Geo. III, c. 85 (1799), reprinted in 18 UK Stat. 175 (1948).

Footnote:

55. See PERKINS & BOYCE, supra note 51, at 363-64 (describing the history of the law of false pretenses and quoting the first false pretenses statute as imposing penalties of fine, imprisonment, the pillory, or transportation for seven years); id. at 352 n.6 (noting that the punishment for embezzlement under the 1799 statute was transportation not to exceed 14 years).

56. See LAFAVE & SCOTT, JR., supra note 27, 8.8(c), at 760-61 (noting that the American criminal system merged crimes of larceny, embezzlement, and false pretenses into a single category, usually referred to as "theft"); PERKINS & BOYCE, supra note 51, at 390-91 (discussing the merger phenomenon as it occurred in California and New York).

57. For example, in Delaware, theft is generally either a Class G felony or a Class A misdemeanor, depending on whether the property taken is worth more or less than $ 500. See DEL. CODE ANN. tit. 11, 841 (1995). Washington divides theft into three degrees based primarily on the value of the thing taken. See WASH. REv. CODE ANN. 9A.56.030(1)(a) (West Supp. 1997-1998); id. 9A.56.040(1)(a); id. 9A.56.050(1) (West 1988). Also in Washington, first and second degree theft are felonies; third degree theft is a gross misdemeanor. Colorado divides theft into four degrees based on the value of the thing taken; there are two felony and two misdemeanor classifications. See COLo. REV. STAT. 6 184-401(2) (1997).

Footnote:

Some states have special laws dealing with bad checks, receiving stolen property, and other variants of simple thievery. See, e.g., WASH. REV. CODE ANN. 9A.56.060 (West 1988) (stating that the crime of unlawful issuance of bank checks is a Class C felony when the amount of the check or checks exceeds $ 250, but a misdemeanor if the amount is $ 250 or less); id.

9A.56.150-9A.56.170 (West 1988 & Supp. 1997-1998) (the crimes of possession of stolen property in the first, second, and third degree are divided into same degrees as theft based on same dollar amounts). However, such offenses are customarily divided into the same number of degrees as is theft itself based on the amount of the bad check or the value of the stolen property. See id.; see also COLO. REV. STAT. 18-4-410 (1997) (stating that theft by receiving is divided into the same degrees as theft, based on value of stolen property received).

Footnote:

58. See, e.g., WASH. REV. CODE ANN. 9A.52.020 (West 1988) (burglary); id. 9A.56.110 (extortion).

59. See, e.g., id. 9A52.020 (defining burglary to include illegal entry made for the purpose of committing a nonproperty crime); id. 9A.56.110 (defining extortion to include obtaining by threat either property or services, including sexual favors); see also United States v. Couch, 65 F.3d 542, 545 (6th Cir. 1995) (observing that the guideline for burglary has a higher base offense level than the theft guideline because "criminal activity that takes place in a dwelling or structure carries with it an increased risk of encountering innocent people and causing physical and psychological injuries").

60. Compare, e.g., WASH. REV. CODE ANN. 9A.56.200(1) (West 1988) (stating that first degree robbery is defined as robbery in which defendant is armed with or displays a deadly weapon or inflicts bodily injury), with id. 9A.56.210(1) ("A person is guilty of robbery in the second degree if he commits robbery.").

Footnote:

61. Compare, e.g., id. 9A.52.020 (stating that first degree burglary is committed where the defendant enters a dwelling and is armed with a deadly weapon or assaults any person therein), with id. 9A.56.030 (stating that second degree burglary is committed where the defendant unlawfully enters building with intent to commit a crime therein); COLO. REV. STAT. 18-4-202(1) (1997) (stating that first degree burglary is committed when the defendant enters a building or occupied structure with intent to commit a crime therein and assaults or menaces another person or is armed with a deadly weapon), with id. 18-4-203 (stating that second degree burglary is committed when the defendant breaks into, enters, or remains unlawfully in a building with intent to commit a crime therein).

62. See JOSHUA DRESSLER, UNDERSTANDING CRIMINAL LAw 32.07, at 518-19 (2d ed. 1995) (stating that the required mental state for larceny is intent to steal); id. 32.09(B), at 524 (describing the required mental state for embezzlement); id. 32.10(A), at 525 (describing the required mental state for false pretenses as intent to defraud).

Footnote:

63. For instance, the consolidated Colorado theft statute, COLO. REV. STAT. 18-4-401 (1997), prohibits direct taking of property from another, obtaining control over property by threat or by deception, knowing use, concealment, or abandonment of the property of another, and unlawfully demanding compensation for the return of another's property, all within the same statute.

64. See George P. Fletcher, The Metamorphosis of Larceny, 89 HARV. L. REV. 469, 476-81 (1976) (describing the concepts of manifest thievery in Roman, biblical, early English, and other Indo-European legal traditions).

65. See id. at 502-20 (describing the evolution of statutory law with respect to larceny); see also GEORGE P. FLETCHER, RETHINKING CRIMiNAL LAW 2.1 to 2.4, at 59-113 (1978) (tracing tha hictnrv and delonment of modern larceny).

Footnote:

66. Of the 989,007 inmates in the custody of State correctional authorities in 1995, 230,300 prisoners (23.3% of the total population) were incarcerated for property off

enses. BUREAU OF JUSTICE STATISTICS, CORRECTIONAL POPULATIONS IN THE UNITED STATES 1995, at 910 tbls. 1.11, 1.12 (1997). Of this total, 10.9% were incarcerated for burglary, 4.8% for larceny, 2.6% for fraud, 2.2% for vehicle theft, and 2.7% for miscellaneous property crimes such as receiving stolen property, destruction of property, etc. Of the crimes reported to state police, larceny-theft offenses

constitute over 50% of all the crimes in the following categories: murder, forcible rape, robbery, burglary, larceny-theft, and motor vehicle theft. BUREAU OF JUSTICE STATISTICS, SOURCEBOOK OF CRIMINAL JUSTICE STATISTICS, Table 3.116 (1993), Table 3.103

Footnote:

(1994), and Table 3.119 (1995). The average property loss (in dollars) incurred for larceny-theft excluding motor vehicle theft ranged from $ 483 (1993) to $ 505 (1995). Id.

67. The Statutory Index to the Guidelines lists almost all the federal statutory provisions prescribing criminal penalties. See USSG app. A (1997). It contains a separate entry for each separately chargeable statutory subsection. The list "specifies the guideline section or sections ordinarily applicable to the statute of conviction." Id. at 417.

Footnote:

68. See id. app. A. 69. See id. 2B2.1. 70. See id. 2B3.1. 71. See id. 2B3.2. 72. See id. 2B3.3. 73. See id. 2B4.1. 74. See id. 2B5.3.

Footnote:

75. The Guidelines provisions for all of these crimes incorporate enhancements for loss. 76. See 7 U.S.C. 6 (1994) (restricting commodities futures trading and foreign transactions).

77. See 15 U.S.C. 77e(a) (1994). 78. 16 U.S.C. 114 (1994). 79. See 18 U.S.C. . 285 (1994). 80. See id. 471.

Footnote:

81. See id. 479 (prohibiting making, altering, or counterfeiting with intent to defraud obligations of foreign governments).

82. See id. 507 (prohibiting falsely making, forging, counterfeiting, or altering registries, licenses, passes, permits, and other ship's papers).

Footnote:

83. See id * 666 (regarding theft, embezzlement or misapplication by bank officers and employees).

84. See id, 1341. 85. See id 1343. 86. See id. 1347.

Footnote:

87. See, e.g., id. 656 (providing that the penalty for embezzlement of less than $ 1000 by a bank employee or officer shall be a fine, imprisonment for not more than one year, or both).

88. Id. 1341, 1343 (providing that the penalty for wire or mail fraud shall not exceed five years).

89. See id. 1344 (providing that penalty for bank fraud shall be a $ 1 million fine, or 30 years imprisonment, or both). 90. Id. 225(a).

Footnote:

91. See, eg., COLO. REV. STAT. 18-1-lOS (1997) (categorizing felonies into six classes); id. 18-1-106 (classifying misdemeanors into three classes); WASH. REV. CODE ANN. 9A.20.010 (West 1988) (categorizing felonies into three classes and misdemeanors into two classes).

92. A notable recent example of the overweening effect of current events on federal criminal sentences is the fourfold, then sixfold, increase in the maximum penalty for bank embezzlement, from five years to 20 years in 1989, and from 20 years to 30 years in 1990, enacted by a Congress in the grip of the savings and loan debacle of the 1980s. Compare 18 U.S.C. 656 (1988) (setting maximum sentence for theft, embezzlement, or misapplication by bank officer or employee at five years imprisonment and a $ 5,000 fine), with Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. 101-73, 103 Stat. 183 (1989) (increasing maximum fine for violation of section 656 from $ 5,000 to $ 1 million, and maximum term of imprisonment from five years to 20 years), and Violent Crime Control and Law Enforcement Act of 1994, Pub. L. 103-322, 108 Stat. 1797 (1994) (increasing maximum term of imprisonment for violation of section 656 from 20 years to 30 years).

Footnote:

93. See United States v. Clevenger, 458 F. Supp. 354, 359 (E.D. Tenn. 1978) (holding that separate counts for separate mailings in furtherance of the same scheme to defraud is not multiplicitous); United States v. Brodbeck, 430 F. Supp. 1056, 1060 (E.D. Wis. 1977) (same); see also United States v. Calvert, 523 F.2d 895, 914 (8th Cir. 1975) (holding each separate use of wire communication in order to aid the same scheme to defraud to be a separate offense).

Footnote:

94. This illustration assumes a sentencing structure employing statutory ranges with minima and maxima. If there were no minima, the top-end constraints would still exist.

95. See, e.g., United States v. Perez, 956 F.2d 1098, 1102-03 (llth Cir. 1992) (affirming the power of a district court to impose consecutive sentences for convictions of burglary and theft arising from the same transaction).

Footnote:

96. See USSG ch. 4. 97. See id. ch. 3, pt. D. 98. See id. 1B1.3. 99. See id. ch. 3, pt. B. 100. See id. ch. 3, pt. A. 101. See id. ch. 5, pt. H. 102. See id. ch. 2.

Footnote:

103. Narcotics sentences are the most prominent exception to the general approach of attempting to reproduce pre-Guidelines sentence levels; largely in response to statutory mandates, the Commission created a structure which dramatically increased drug sentences. See generally Bowman, supra note 10, at 733-34, 740-47 (discussing drug sentences under the Guidelines and arguing that they are, in many cases, too long).

104. See Breyer, supra note 10, at 7 n.50 (analyzing the basic principles behind the Guidelines' enactment).

Footnote:

105. See id. at 20-21 (discussing the Commission's decision to increase the severity of punishment for white collar crimes); Marvin E. Frankel, Sentencing Guidelines: A Need for Creative Collaboration, 101 YALE L.J. 2043, 2047 (1992) ("(T)he Commission produced guidelines that actually increase the overall severity (of federal sentences)-taking particular aim at so-called white-collar offenders whom the Commission found (perhaps correctly) to have been treated with undue solicitude.').

106. As Justice Breyer, then a member of the Sentencing Commission, said in 1988, "A preGuidelines sentence imposed on these criminals would likely take the form of straight probationary sentences." Breyer,

supra note 10, at 7 n.49; see also John Hagan & Ilene Nagel Bernstein, The Sentence Bargaining of Upperworld and Underworld Crime in Ten Federal District Courts, 13 L. & Soc'Y REV. 467, 475 (1979) (quoting a U.S. Attorney regarding office policy of vigorous advocacy in white collar sentencing hearings "because unless we did (advocate stronrlv for imprisonment) almost everybody would walk out on probation").

Footnote:

107. Breyer, supra note 10, at 20; see also United States v. Weaver, 126 F.3d 789, 792-93 (6th Cir. 1997) (loss table reflects seriousness with which Sentencing Commission took low-level white-collar crime; district court erred in departing down based on dissatisfaction with guideline range).

Footnote:

108. See Bowman, supra note 10, at 734-40 (supporting the Commission's choice to increase economic crime sentences, and arguing that, even under the Guidelines, federal white collar sentences are often too low). The Commission is presently considering raising economic crime sentences further by amending the loss tables in section 2B1.1 and section 2F1.1 to raise the sentences associated with amounts of loss in the middle and upper ranges of the tables. For discussions of these proposed changes, see Frank 0. Bowman, III, Back to Basics: Helping the Commission Solve the Loss" Mess with Old Familiar Tools, 10 FED. SENTENCING REP. 115, 11516 (Nov.-Dec. 1997); and Barry Boss, Do We Need To Incresase the Sentences in "White Collar" Cases? A View from the Trenches, 10 FED. SENTENCING REP. (Nov.-Dec. 1997). 109. In the commentary to the fraud guideline, the Commission observes: Empirical analyses of pre-guidelines practice showed that the most important factors that determined sentence length were the amount of loss and whether the offense was

Footnote:

an isolated crime of opportunity or was sophisticated or repeated. Accordingly, although they are imperfect, these are the primary factors upon which the guideline has been based.

USSG 2F1.1 background commentary. The commentary to the theft guideline states:

The value of the property stolen plays an important role in determining sentences for theft and other offenses involving stolen property because it is an indicator of both the harm to the victim and the gain to the defendant... The guidelines provide an enhancement for more than minimal planning, which includes most offense behavior involving affirmative acts on multiple occasions. Planning and repeated acts are indicative of an intention and potential to do considerable harm. Also, planning is often related to increased difficulties of detection and proof. Id. 2B1.1 background commentary.

Footnote:

110. Id. at ch. 2, pt. B(1), introductory commentary. Property damage cases are nominally sentenced under section 2B1.3, but the core of that guideline is a cross-reference to section 2B1.1 incorporating the loss table of section 2B1.l(b)(1).

111. Id. 2B1.1 (omitting subsec. 2Bl.l(c) concerning cross-references and application notes).

112. See id. 2F1.1 (omitting application notes). 113. LUKE 16:26.

Footnote:

114. USSG 2B1.1 (omitting application notes and subsection 2B1.1(c) (concerning crossreferences)).

Footnote:

115. Id. 2F1.1 (omitting application notes).

Footnote:

116. The word "loss" appears in guideline text only as a description of the monetary increments in two tables (section 2B1.1(b)(1) and section 2Fl.l(b)(1)) which give rise to increases in offense level. See, e.g., id. 2B1.l(bXl) (1997) (stating that "(i)f the loss exceeded $ 100, increase the offense level as follows: (followed by a loss table)"). 117. Id. 2B1.1 application note 2. Application Note 2 goes on to say: Ordinarily, when property is taken or destroyed the loss is the fair market value of the particular property at issue. Where the market value is difficult to ascertain or inadequate to measure harm to the victim, the court may measure loss in some other way, such as reasonable replacement cost to the victim. Loss does not include the interest that could have been earned had the funds not been stolen. When property is damaged, the loss is the cost of repairs, not to exceed the loss had the property been destroyed. Id.

Footnote:

118. Id. 2F1.1 application note 7 ("Valuation of loss is discussed in the Commentary to section 2B1.1 (Larceny, Embezzlement, and Other Forms of Theft). As in theft cases, loss is the value of the money, property, or services unlawfully taken .....).

119. Id. (emphasis added). For further discussion of this issue, see infra notes 147-71 and accompanying text.

120. See id. 2F1.1 application note 7(c). 121. See id. 2F1.1 application note 7(d). 122. See id. 2F1.1 application note 7(e).

123. Id. 2B1.1 application note 3; id. 2F1.1, application note 8.

Footnote:

124. This rule is plainly stated only in the fraud guideline: "Consistent with the provisions of section 2X1.1 (Attempt, Solicitation or Conspiracy), if an intended loss that the defendant was attempting to inflict can be determined, this figure will be used if it is greater than the actual loss.' Id. 2F1.1 application note 7. Nonetheless, the same principle is implicit in the examples used for illustration in the theft guideline:

(1) In the case of a theft of a check or money order; the loss is the loss that would have occurred if the check or money order had been cashed. (2) In the case of a defendant apprehended taking a vehicle, the loss is the value of the vehicle even if the vehicle is recovered immediately. Id. 2B1.1 application note 2.

Footnote:

However, it may be that these examples are best seen as efforts to deal with the problem of when loss should be measured, rather than as illustrations of the principle of intended loss. See infra Part IV.C.1 for discussion of the "when" problem.

The concept of intended loss is explicitly imported into the theft guideline only in cases of attempt:

In the case of a partially completed offense (e.g., an offense involving a completed theft that is part of a larger, attempted theft), the offense level is to be determined in accordance with the provisions of section 2X1.1 (Attempt, Solicitation, or Conspiracy) whether the conviction is for the substantive offense, the inchoate offense (attempt, solicitation, or conspiracy), or both; see Application Note 4 in the Commentary to section 2X1. 1. USSG 2B1.1 application note 2. The base offense level for an attempted theft is determined by adding to the

base offense level of the substantive offense "any adjustments from such guideline for any intended offense conduct that can be established with reasonable certainty." Id. 2Xl.l(a).

Footnote:

125. See USSG 2Bl.l(a). 126. See id. 2Bi..i(bX)(XN). 127. See id. 2Bl.l(bX2). 128. See id. 2Fl.l(a). 129. See id. 2FI.l(b)(1)(L).

Footnote:

130. For example, frauds of less than $ 2,000 receive no upward adjustment from the loss table, see id. 2Fl.l(b)(1XA) (1997), while thefts of between $ 100 and $ 1,000 receive a one-level upward adjustment, see id. 2B1.1(b)(1)(B). Therefore, because the base offense level for frauds is 6, and the base level for thefts only 4, a theft of $ 500 would have an offense level of 5, while a fraud in the same amount would produce an offense level of 6. For any loss amount greater than $ 1,000, this effect disappears.

Footnote:

131. Id. 2Bi..I(bX)(4XA), 2Fl.l(bX2). 132. See id. 2Bl.l(b) (theft); id 2Fl.l(b) (fraud).

Footnote:

133. Common law larceny is the taking and carrying away of the personal property of another with the intent to permanently deprive the possessor of the property. See DRESSLER, supra note 62, 32.02(A), at 508.

134. See LAFAvE & SCOTT, JR., supra note 27, at 711 n.33 (citing Rex v. Pear, 168 Eng. Rep. 208 (1779) (holding that leasing a horse for part of a day and then selling it under pretense of ownership is forgery)). Larceny by trick is merely one means of committing the crime of larceny. It is a rule that extends the reach of larceny to cases in which the defendant "obtains possession of, but not title to, another's property by lies, then intending fraudulently to convert the property and later doing so.' Id. at 711.

135. "The primary difference between larceny and false pretenses is that a thief who uses trickery to secure title, and not simply possession, of property, is guilty of false pretenses; one who merely secures possession through fraud is guilty of larceny by trick." DRESSLER, supra note 62, 32.10(B), at 525.

Footnote:

136. "The most significant distinction between larceny and embezzlement is that li)n embezzlement, the property comes lawfully into possession of the taker and is fraudulently or unlawfully appropriated by him; in larceny, there is a trespass in the unlawful taking of the property.'" Id. 32.09(C), at 524 (citation omitted). 137. See 18 U.S.C. 1343 (1994). 138. See id. 1341.

139. In fact, one of the traditional elements of embezzlement is fraudulent conversion of property; however, *fraudulent" in this sense does not require the making of any false statement upon which a victim relied. Rather, it simply means that the defendant "performed some act that demonstrated his intent to deprive another of the property permanently." DRESSLER, supra note 62, 32.09(B), at 524.

140. For example, in most employee embezzlement cases, the defendant will be obliged at some stage to make some false oral statement or bookkeeping entry to cover up or account for the shortfall in property or funds.

Footnote:

141. See MODEL PENAL CODE 223.1-223.8 (1980).

142. For example, Washington state's consolidated theft statute specifies that theft, meaning "to wrongfully obtain or exert control over the property or services of another . . . with intent to deprive him of such property or services,' may be committed "(b)y color or aid of deception." WAsH. REV. CODE ANN. 9A.56.020(1) (West 1988).

143. Federal law has made more of an effort than the states to keep theft and fraud statutes separate. However, all of the state property crime statutes may become a part of federal law under the Assimilative Crimes Act. See 18 U.S.C. 13 (1994) (assimilating state law into federal law for offenses committed in federal enclaves).

Footnote:

144. See supra note 132 and accompanying text.

145. See supra notes 116-19 and accompanying text; see also USSG 2F1.1 cmt. 1 (1997). 146. The Sentencing Table is constructed so that the top of one sentencing range will overlap the bottom of the range two offense levels higher. See USSG ch. 5, pt. A (1997).

Footnote:

147. See, e.g., Marc Miller, Rehabilitating the Federal Sentencing Guidelines, 78 JUDIcATURE 180 (1995); Gerald F. Uelmen, Federal Sentencing Guidelines: A Cure Worse Than the Disease, 29 AM. CRIM. L. REV. 899, 902 (1992) ("The problem of sentencing disparity is not unique to the federal criminal justice system. Only the federal system has produced a solution which outweighs the Manhattan telephone directory, however."); Jose A. Cabranes, Editorial, Incoherent Sentencing Guidelines, WALL ST. J., Aug. 28, 1992, at All (referring to the Guidelines as aa byzantine system of rules"). 148. 951 F.2d 521, 523-24 (3d Cir. 1991). 149. Id. at 529.

Footnote:

150. Id.

Footnote:

151. See supra note 124 for discussion of the differences between section 2B1.1 and section 2F1.1 regarding intended loss. 152. Kopp, 951 F.2d at 529-530. 153. See supra notes 125-43 and accompanying text.

154. See United States v. Titus, 64 F. Supp. 55 (D.N.J. 1946) (holding that intent to repay and actual reimbursement was no defense to embezzlement where army post exchange employee took cigarettes, sold them to a civilian at a high price, and deposited an amount equal to the low post exchange price in the cash register while pocketing the rest). See generally LAFAvE & SCOTT. JR.. SUDra note 27. at 736-38.

Footnote:

155. Kopp, 951 F.2d at 530 n.13. The court stated in footnote 13, "We can imagine one situation where our reconciliation of USSG 2B1.1 and 2F1.1 might fail, however(,) . . . embezzlement crimes." Id. One difficulty with this rather dismissive characterization is that embezzlement crimes are a common fixture of the federal criminal landscape, and are regularly sentenced under section 2B1.1. 156. 954 F.2d 928 (3d Cir. 1992).

Footnote:

157. See id. at 938. 158. See id.

159. See id.; Kopp, 951 F.2d at 530 n.15. 160. 63 F.3d 1239 (3d Cir. 1995).

Footnote:

161. Id. at 1251. Another marked peculiarity of this approach is that gross gain, which the Third Circuit views as especially appropriate to theft-like offenses sentenced under section 2B1.1, has never been mentioned in the commentary to section 2B1.1.

Footnote:

162. See USSG App. C., amend. 393, at 221 (Nov. 1, 1991). 163. 64 F.3d 818 (3d Cir. 1995). 164. Id. at 825.

Footnote:

165. Id. at 826.

166. 76 F.3d 1304 (3d. Cir. 1996). 167. See id. at 1308. 168. See id. at 1312. 169. See id. at 1310-11.

Footnote:

170. Perhaps in recognition of the difficulties Kopp, Badaracco, and Coyle had created, the Third Circuit in Maurello went on to say:

The mere fact that defendant's scheme involved a breach of fiduciary duty does not bring it under the penumbra of Badaracco...

(E)ven if we agreed with the government's analogy (to Badaracco), we would reject their argument that "gross gain" to the defendant is the appropriate measure of loss under Badaracco because the portion of the fraud guideline on which that holding was based has been amended. In Badaracco, we held that the analogy to embezzlement justified our using the "gross gain" alternative to estimate "loss," expressly authorized in Application Note 8. In 1991, however, Application Note 8 was amended... Although we do not need to reach this issue in this case, it seems clear that the guidelines no longer endorse "gross gain" to the defendant as an alternative measure of loss. Id. at 1311.

Footnote:

171. For another example of confusion over whether section 2B1.1 or section 2F1.1 applies to a case, compare United States v. Dion, 32 F.3d 1147, 1149 (7th Cir. 1994) (holding section 2F1.1 inapplicable to 18 U.S.C. 656, misapplication of bank funds), with United States v. Lucas, 99 F.3d 1290, 1294 (6th Cir. 1996) (holding that section 2F1.1 does apply to 18 U.S.C. 656, and characterizing Dion as a "questionable case"). 172. See Statute of Westminster I, 1275, 3 Edw., ch. 15 (Eng.). 173. See supra notes 21-22 and accompanying text.

Footnote:

174. See STANTON WHEELER ET AL., SING IN JUDGMENT: THE SENTENCING OF WHITE COLLAR CRIMINALS (1988). 175. See supra note 109.

176. See WHEELER ET AL., supra note 174, at 93-94. 177. See id. at 97-102. 178. See id.

Footnote:

179. See id. at 120-21. 180. See id.

181. See USSG 2Bl.I(b)(4XA); id. 2Fi.l(bX2XA). 182. See id. 3B1.1, 3B1.2. 183. See id. i 3B1.3.

Footnote:

184. See id. 3E1.1 (conferring two- or three-level offense level reductions where a defendant "demonstrates acceptance of responsibility for his offense"). Of course, realists with some experience of federal sentencing

would doubtless say that the "acceptance of responsibility" credit has more to do with rewarding early guilty pleas and the resultant saving in governmental resources than it does with an assessment of contrition.

185. See id. 5K1.1; see also Bowman, supra note 10, at 722-24 (discussing sentence reductions for substantial assistance under section 5K1.1). 186. See U.S. Sentencing Commission, 1995 Datafile MONFY 95.

Footnote:

187. See 63 Fed. Reg. No. 3, pt. II (Jan. 6, 1998); Memorandum from John R. Steer, General Counsel, U.S. Sentencing Commission, to U.S. Sentencing Commission (June 26, 1997) (on file with author). For discussion of the pros and cons of this proposal, see Hearing before U.S. Sentencing Commission, March 5, 1998, testimony of Mary Spearing, Chief, Fraud Section, U.S. Department of Justice and defense attorney David Axelrod, written statements and transcripts of testimony available at <<http://www.ussc.gov/hearings.htm>>. Section 2Tl.l(b)(2) (1997) imposes a two-level increase in offense level where "sophisticated means were used to impede discovery of the existence or extent of the offense."

188. A proposed sophisticated means adjustment appears at section 2Zl.l(bX8) in the proposed consolidated economic crimes guideline in Appendix A. The proposed guideline defines "sophisticated means" in virtually the same language used in section 2T1. 1:

Footnote:

Sophisticated means," as used in subsection ()flO), includes conduct that is more complex or demonstrates greater intricacy or planning than a routine economic crime of the same type. An enhancement would be applied, for example, where the defendant used offshore bank accounts, multiple transactions through domestic financial institutions, transactions through corporate shells or fictitious entities, or sophisticated technical means.

Appendix A, Proposed 2Zl.1 n.16. (I confess that I do not find this language entirely satisfactory.)

Footnote:

189. Sentence length in narcotics cases is determined almost entirely by the weight of the drugs possessed, sold, and distributed. See USSG 2D1.1.

Footnote:

190. See, e.g., Chapman v. United States, 500 U.S. 453 (1991) (discussing whether weight of .mixture and substance" containing a controlled substance includes weight of the carrier medium, e.g., blotter paper in the case of LSD). 191. See USSG 2Bl.l(b)(4XA), 2FI..I((bX2)(A).

Footnote:

192. The proposed enhancement for number of victims reads: If the offense involved more than one victim, increase the offense level as follows: (A) If the offense involved 2-4 victims, increase by 1 level (B) If the offense involved 5-20 victims, increase by 2 levels. (C) If the offense involved 21 or more victims, increase by 3 levels.

Footnote:

Appendix A, Proposed 2Z1.1(bxl0). 193. See USSG 3A1.1.

194. Id. 2F1.1 n.lO(f), construed in United States v. Hogan, 121 F.3d 370, 373 (8th Cir. 1997) (approving upward departure for knowingly endangering solvency of defrauded victims).

Footnote:

195. Id. 2B1.1.

196. See DRESSLER, supra note 62, 32.04, at 510. 197. See USSG 2F1.1 application note 7.

Footnote:

198. For example, if "taken" retains some vestige of its common law meaning, then what does it mean to speak of "taking" in the context of wire fraud, bankruptcy fraud, or an insider trading case?

199. So far as I can determine, neither has any court of appeals. See, e.g., United States v. Barrett, 51 F.3d 86, 89 (7th Cir. 1995) ("This court has not previously defined the scope of the term 'victim' under (section) 2F1.1 of the Guidelines."). Nor did the Barrett court hazard a comprehensive definition of the term "victim." 200. See USSG 1B1.3.

Footnote:

201. 32 F.3d 1387 (9th Cir. 1994).

202. See id. at 1388. See generally 18 U.S.C. 1341 (1994) (mail fraud); 12 U.S.C. 1709-2 (equity skimming); 18 U.S.C. 371 (conspiracy).

203. See Harper, 32 F.3d at 1388. In reaching its decision, the district court relied on the Tenth Circuit's decision in United States v. Johnson, 941 F.2d 1102 (lOth Cir. 1991). See Harper, 32 F.3d at 1390. 204. See Harper, 32 F.3d at 1392.

Footnote:

205. See id.

206. The court in Harper rejected the idea that the amount of deficiency judgments entered against the original owners following foreclosure would necessarily be the measure of "loss." Id. The court said that, "(i)f it can be shown that a portion or all of the deficiency was brought about by Harper's actions, that loss could be considered a part of the actual loss inflicted by him." Id. Presumably, the court agreed that the deficiency should be a component of loss if the defendant's actions which caused an owner to vacate his home and suspend mortgage payments led directly to a foreclosure which the owner might otherwise have been able to prevent. 207. See id.

Footnote:

208. 12 U.S.C. 1709-2 makes it a felony for any person, with the intent to defraud, to willfully engage in a pattern or practice of (1) "purchasing one-to four-family dwellings" owned by persons whose loans are in or near default and are secured by mortgages or deeds of trust held or insured by HUD or the Veterans Administration, (2) failing to make payments on the loans, and (3) collecting rent and appropriating it to his own use. 12 U.S.C. 1709-2. 209. See infra Part IV.B.2.e.

210. Similarly, even if the equity skimming charges remained, but some of the homes involved in the scheme to defraud were not purchased with federally insured loans, a congressional intent approach to loss would presumably exclude losses suffered by the lenders on those homes even though they were a part of the same overall scheme.

Footnote:

211. See supra note 48 and accompanying text (discussing relevant conduct and modified real offense sentencing).

212. 76 F.3d 1304 (3d Cir. 1996). Maurello is discussed above in connection with the consolidation of section 2B1.1 and section 2F1.1. See supra notes 166-71 and accompanying text. 213. See Maurello, 76 F.3d at 1311-12. 214. Id. at 1313. 215. Id.

Footnote:

216. Indeed, the court's explanation of its result is entirely circular. It said that it disagreed with the government's argument because that argument would compel use of the total amount of fees in all such cases, and that this "would render the degree of harm caused by a defendant's acts irrelevant to Guidelines sentencing-a result that is contrary to the policy of the Guidelines." Id. But the result argued for by the government only renders the degree of harm "irrelevant to Guidelines sentencing" if harms to "remote victims" do not count. The court never explained who qualifies as a remote victim or why inJuries to such a victim do not and should not count.

Footnote:

217. See USSG 2F1.1 application note 8 ("The offender's gain from committing the fraud is an alternative estimate that ordinarily will underestimate the loss."). The background commentary to the theft guideline states: "The value of the property stolen plays an important role in determining sentences for theft and other offenses involving stolen property because it is an indicator of both the harm to the victim and the gain to the defendant.' USSG 2B1.1 background commentary. "Gain" is also used to set the sentence for insider trading offenses. See id. 2F1.2(bXl).

218. See, e.g., United States v. Brewer, 60 F.3d 1142, 1145 (5th Cir. 1995) (holding it .proper to calculate loss based on the risk engendered by the defendant's criminal conduct even where the actual loss was lower").

Footnote:

219. Compare United States v. Marcus, 82 F.3d 606, 610 (4th Cir. 1996) (holding "gross sales were the appropriate measure of the actual loss"), with United States v. Chatterji, 46 F.3d 1336, 1340 (4th Cir. 1995) (holding "gain 'may not support an enhancement'" under section 2F1.1(b)(1) of the Guidelines).

Footnote:

220. 1991 amendment of 2 2F1.1 application note 7, to add subsection (d). See USSG App. C, amend. 393 (Nov. 1,1991).

221. Assuming, of course, that the loan is repaid. 222. 76 F.3d 1304,1313 (3d Cir. 1996).

Footnote:

223. USSG 1B1.3(aX3).

224. Id. 1B1.3(aX2), construed in United States v. O'Brien, 119 F.3d 523, 535 n.9 (7th Cir. 1997) (relevant conduct rules allow judges to include in loss calculation losses not mentioned in indictment).

225. 53 F.3d 1100 (lOth Cir. 1995), cert. denied, 116 S. Ct. 796 (1996). 226. See id. at 1104-05; see also United States v. Allender, 62 F.3d 909, 916 (7th Cir. 1995) (holding that amounts of fraudulently obtained loans from transactions not charged in the indictment, and from a transaction for which defendant was acquitted, properly included in loss calculation), cert. denied, 116 S. Ct. 781 (1996). 227. USSG 1B1.3(ax3), lBl.3 (aXl)(B).

Footnote:

228. See, e.g., United States v. Zaragoza-Barajas, 123 F.3d 472, 477 (7th Cir. 1997) (defendant responsible for all losses in unemployment compensation fraud because, given her .absolutely integral and essential" role in the scheme, the entire loss was foreseeable to her); United States v. Dolan, 120 F.3d 856, 871 (8th Cir. 1997) (attorney liable for all losses from

Footnote:

client's bankruptcy fraud scheme); United States v. O'Neil, 118 F.3d 65, 75 (2d Cir. 1997) (defendant responsible for all loss caused by fraudulent telemarketing firms of which he was part-owner because misrepresentations by sales staff were foreseeable); United States v. LaCroix, 28 F.3d 223, 231 (lst Cir. 1994) (holding defendant responsible for 90 or more homes sold fraudulently by the conspiracy); United States v. Jackson, 25 F.3d 327, 330 (6th Cir. 1994) (holding defendant responsible for all losses caused by his associates in an insurance and credit card fraud scheme).

Footnote:

229. USSG lB1.3, Application Note 2, states: "The requirement of reasonable foreseeability applies only in respect to the conduct. . . of others under subsection (axl)(B). It does not apply to conduct that the defendant personally undertakes, aids, abets, counsels, commands, induces, procures, or willfully causes; such conduct is addresed under subsection (a)(1)(A).'

Much of the quoted language is, of course, internally contradictory. The Application Note says reasonable foreseeability applies to the conduct of others but not to conduct the defendant "aids, abets . (etc" But "others" are the only people whose conduct a defendant can aid, abet, counsel, command, induce or procure. So when does the reasonable foreseeability apply? 230. USSG 2F1.1 application note 7(c).

Footnote:

231. See United States v. Thomas, 62 F.3d 1332, 1346-47 (llth Cir. 1995), cert. denied, 116 S. Ct. 1058 (1996) (stating that by adopting USSG 2F1.1, Application Note 7(c), "he Commission . . . expressly considered and rejected consequential damages as a factor in determining offense levels under the Sentencing Guidelines, except for government procurement and product substitution cases").

232. In concluding that Application Note 7(c) states a general rule of causation, I assume that "damages" is intended to mean the same thing as "loss." If not, and if there is supposed to be some difference between "loss" and "damage," the matter becomes even more obscure. 233. See generally JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 10-4 (Damages for Breach of Warranty-Consequential Damages) (4th ed. 1995). 234. "The law of contracts is concerned with the securing and protection of those economic interests which result from assurances." JOHN EDWARD MURRAY, JR., MURRAY ON CONTRACTS ffi 1 at 2 (1974).

Footnote:

235. We . . . describe a contract as a promise, or a group of promises, which the law will enforce, or the performance of which it in some way recognizes as a duty.' Id. 2, at 3. 236. See id. 2, at 3. 237. Murray states:

The purpose of contract law is often stated as the fulfillment of those expectations which have been induced by the making of a promise. If the promise is breached the legal system protects the expectations by attempting to place the injured promisee in the position he would have been in had the promise been performed. Id. 219, at 438.

238. See id. 219, at 439.

Footnote:

239. See id. 219, at 438.

240. In loan fraud, a defendant makes misrepresentations to induce a bank to enter into a loan contract. In procurement fraud, a contractor agrees to provide goods of a certain type to the government, but fails to do so and conceals the failure by fraud.

241. See, e.g., United States v. Kimbrough, No. 96-2816, 1997 WL 73828 (7th Cir. Feb. 14, 1997) (unpublished disposition), in which the defendant committed telecommunications fraud under 18 U.S.C. 1029(aX5), (bX2) (1994), by manufacturing and selling cloned cellular telephones. The economic harm was incurred by cellular telephone companies who provided air time free to those who purchased the cloned phones from the defendant, but the defendant had no contractual relationship, or indeed any contact whatever, with the telephone company victims.

242. Discussed supra notes 201-07 and accompanying text. 243. 24 F.3d lOOS (7th Cir. 1994).

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244. Id. at 1007.

245. 156 Eng. Rep. 145 (Ex. 1854). See WHITE & SUMMERS, supra note 233, 10-4, at 314 (*Most of the law regarding consequential damages can be traced back to . . . Hadley v. Baxendale.").

246. See WHITE & SUMMERS, supra note 233, 10-4, at 564; 5 A CORBIN, CORBIN ON CONTRACTS 1010, at 79 (1964); see also U.C.C. 2-715(2) (1995) (stating that a defendant would be liable for "any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know.....). 247. See U.C.C. 2-715 & cmt. 3.

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248. See United States v. King, 915 F.2d 269, 272 (6th Cir. 1990) (construing section 2B2.2(b)(2), which incorporates the loss table of section 2B1.1, to include in loss "incidental or consequential damages," such as the cost of hiring security guards while bank vault damaged by defendant was repaired); United States v. Jones, 933 F.2d 353, 354-55 (6th Cir. 1991) (citing King to hold that interest accrued on purchases made with fraudulently obtained credit cards is a component of loss under section 2F1.1). The continued validity of these holdings is in some doubt, however, because both predate the November 1, 1991, addition of section 2F1.1, Application Note 7(c), excluding "consequential damages" from loss in all but product substitution and procurement fraud matters. See USSG App. C, amend. 393, at 223 (Nov. 1, 1991). On the other hand, the Sixth Circuit has never expressly overruled King, and indeed cited it approvingly in an unpublished opinion after the addition of Application Note 7(c). See United States v. Majszak, No. 91-2179, 1992 WL 188114, at *1 (6th Cir. Aug. 6, 1992) (unpublished disposition) ("We have interpreted (section 2B1.1 n.2) to mean the amount of the victims' 'net out of pocket loss,' including all incidental and consequential damages, as well as accrued interest."); see also United States v. Hoffman, No. 95-3445, 1995 WL 465799, at *3-4 (6th Cir. Aug, 1995) (unpublished disposition) (including consequential damages in loss in procurement fraud case. citing section 2F1.1 auolication note 7(c)).

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249. See, e.g., United States v. Daddona, 34 F.3d 163, 171-72 (3d Cir. 1994) (stating that consequential and incidental damages are not included in loss); United States v. Marlatt, 24 F.3d 1005, 1007 (7th Cir. 1994) (stating that consequential and incidental damages "are not to be counted in computing loss"); United States v. Newman, 6 F.3d 623, 630 (9th Cir. 1993) (stating that loss does not include consequential damages); United

States v. Wilson, 993 F.2d 214, 217 (llth Cir. 1993) ("The phrase 'property taken, damaged, or destroyed' does not allow for inclusion of incidental or consequential injury. ..."); United States v. Santiago, 977 F.2d 517, 525-26 (lOth Cir. 1992).

250. See United States v. Thomas, 62 F.3d 1332, 1346 (llth Cir. 1995), cert. denied, 116 S. Ct. 1058 (1996) (citing United States v. LNU, 16 F.3d 1168, 1170 (llth Cir. 1994), modified, United States v. Omar, 24 F.3d 1356 (llth Cir. 1994)). The court considered the express inclusion of consequential damages as part of the loss measurement for product substitution and government procurement cases in USSG section 2F1.1, application note 7(c), and concluded that, "(t)he fact that the Commission deliberately allowed an increase for consequential damages in some but not all types of frauds indicates that 'the absence of an increase . . . is a result of design rather than inadvertence.'" The court left room for a departure based on consequential damages "outside the heartland" considered by the Commission, id. at 1347, but did not suggest the factors which might make consequential damages sufficiently extraordinary to warrant departure.

Footnote:

251. 993 F.2d 214 (llth Cir. 1993). 252. See id. at 216, 218. 253. 43 F.3d 1298 (9th Cir. 1995). 254. See id. at 1302. 255. Id. at 1302-03. 256. Id. at 1303.

257. In United States v. Ortland, the Ninth Circuit apparently relaxed the "direct causation" requirement when it characterized Mende as having "rejected a claim that all somewhat

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indirect fraud losses are a type of 'consequential' damages that cannot be considered under (section) 2F1.1.. 109 F.3d 539, 548 (9th Cir. 1997). Cf United States v. Sablan, 92 F.3d 865, 870 (9th Cir. 1996) (suggesting that certain personnel costs incurred by the victim bank during the investigation of defendant's computer fraud, though a foreseeable result of the fraud, might not be includable as loss because they were consequential damages).

258. Moreover, several components of the economic harm the Mende court included in loss, notably the stock losses and $ 500,000 in other actual losses, would clearly be considered consequential damages in a contracts case, and therefore should be excluded from "loss" if the phrase .consequential damages" is to retain any vestige of its meaning as a term of art. 259. 24 F.3d 1005 (7th Cir. 1994).

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260. Although the opinion is vague on the point, the presumable ground for such an action was that the defendant was an agent of the title insurer who inveigled the buyers into purchasing soon-to-be worthless property in part in reliance on assurances of clear title bearing the imprimatur of the title insurer.

261. See, e.g., United States v. Green, 114 F.3d 613, 618 (7th Cir. 1997) ("consequential or incidental damages" not to be included in loss calculation); United States v. Morris, 80 F.3d 1151, 1173 (7th Cir. 1996) (although a defendant's fraud may be a "but for" cause of such damages, such damages are not included as loss under section 2Fl.1); Creek v. Village of Westhaven, 80 F.3d 186, 189 (7th Cir. 1996) ("Causation in the law is not to be equated to 'but for' causation."); United States v. Barrett, 51 F.3d 86, 89 (7th Cir. 1995) (money spent by title

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insurer to clear titles includable as loss); see also United States v. Barker, No. 95-3262, 1996 WL 294141, at *2 (lOth Cir. June 4, 1996) (unpublished disposition) (consequential damages are not to be included in the

calculation of loss for purposes of section 2F1.1); United States v. Neadle, 72 F.3d 1104, 1118 (3d Cir. 1996) (Becker, J., concurring and dissenting) (suggesting a "need for finding causation in making a loss determination"); United States v. Gottfried, 58 F.3d 648, 651 (D.C. Cir. 1995) (stating that decisions holding incidental or consequential damages may not be counted toward loss are not persuasive); United States v. Daddona, 34 F.3d 163, 171-72 (3d Cir. 1994) (consequential and incidental damages are generally not to be included as loss under section 2F1.1).

262. Marlatt, 24 F.3d at 1007.

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263. Id.

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264. Id. (citing Brackett v. Peters, 11 F.3d 78, 79-80 (7th Cir. 1993)). 265. Despite Judge Posner's studied avoidance of the term *proximate cause," Judge Becker of the Third Circuit read Marlatt as "applying proximate cause analysis." Neadle, 72 F.3d at 1118 (Becker, J., concurring and dissenting).

266. See Marlatt, 24 F.3d at 1007-08. The opinion refers to Application Note 7(b), which is the same as the current Note 7(c).) 267. Id.

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268. I say "reasonably convincing" because, even on its own terms, the opinion is open to question. Whether the money paid by the title insurer to purchase its insureds' units would be a direct or consequential damage in civil law depends on what civil lawsuit one considers. Presumably, the hypothetical suit would be by the title company against the criminal defendant for breach of the agency contract and fraud. It is not at all clear that the insurer's payouts to its insureds, whether made under threat of suit or not, would necessarily be considered a consequential rather than a direct damage flowing from either the breach of the agency agreement or the fraud or both.

269. 51 F.3d 86 (7th Cir. 1995). 270. Id. at 91.

Footnote:

271. Id.

Footnote:

272. The recent case of United States u. O'Brien, 119 F.3d 523 (7th Cir. 1997) muddied the waters further still. Defendant O'Brien was convicted of bank fraud and wire fraud for taking out loans secured by the assets of her oil delivery company and then selling those assets to another company by claiming that they were unencumbered. The successor company was forced to pay the bank to satisfy the liens, and both it and the bank suffered losses. At sentencing, the district court included in the loss calculation as relevant conduct more than $ 40,000 the defendant had obtained from her principal oil supplier, North Shore Oil, by ordering oil, selling it, and sticking to the proceeds. See id. at 534. The Seventh Circuit rejected the defendant's claim that the North Shore losses were excludable consequential damages, employing reasoning closer to the Ninth Circuit's direct causation analysis in Mende than to Judge Posner's merger of contract law with the "thing taken" language of section 2F1.1. The court wrote: Consequential damages are defined as "damage, loss or injury as does not flow directly and immediately from the act of the party, but only from some of the consequences or results of such act... Damages which arise from intervention of special circumstances not ordinarily predictable." In this case,

there was ample evidence from which the court could, and did, conclude that the loss caused to North Shore Oil arose as a direct result of O'Brien's fraudulent scheme.

Footnote:

Id. at 535 n.9 (citation omitted). 273. 58 F.3d 648 (D.C. Cir. 1995). 274. See id. at 649-50. 275. See id. at 649.

Footnote:

276. See id. at 651. 277. See id. 278. See id. 279. See id. at 651-52. 280. See id. at 652. 281. The court stated:

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The cost of redoing the thirty-two appeals Gottfried had been assigned to handle was a direct result of his crime. It followed immediately as a consequence of his unlawful action. If Gottfried had not violated the law, the appeals would have been handled once, by him. His illegal initial processing of the appeals forced the Board to reprocess them. Id.

Footnote:

Judge Henderson's concurrence aptly noted that "the property loss valuation provisions of the Guidelines are a bad fit for the kind of crime committed here (in that they focus on the value of the property taken or damaged rather than the extent of the actual harm caused by the criminal activity)." Id. at 653 (Henderson, J., concurring). The concurrence also suggested that an upward departure would be a better approach than straining to assess an economic harm. Id. (Henderson, J., concurring).

See also United States v. Berkowitz, 927 F.2d 1376 (7th Cir. 1991), in which the court assessed a defendant convicted of destroying government documents for loss it equated with the costs incurred in undoing the full extent of the damage, including the costs of "reorganizing the documents," "reinterviewing the witnesses," and "obtaining" and "recopying" the documents. Id. at 1390. Said the court, '(T)ime a person spends doing one thing is time that person cannot spend doing something else; therefore, opportunity costs must also be factored into the cost of replacing the documents." Id. Berkowitz was decided prior to the adoption of Application Note 7(d) excluding "consequential damages" in most cases, and is thus of dubious precedential value.

Footnote:

282. See United States v. Hoffman, No. 95-3445, 1995 WL 465799 (6th Cir. Aug. 4, 1995) (unpublished), in which the court relied on USSG section 2F1.1, Application Note 7(c), for the proposition that in procurement fraud or product substitution cases, consequential damages may be part of the loss. In this case, consequential losses included payment for unusable goods and storage costs, removal and inspection of the nonconforming goods, and the cost of holding usable goods in evidence. See id.; see also United States v. Leahy, 82 F.3d 624 (5th Cir. 1996) (including in loss the amount roofing company overcharged, the amount of false bond premiums, the amount of additional materials the government had to purchase to complete the project, and the amount of physical damage caused by defendant's company). 283. USSG 2F1.1 application note 7(c).

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284. It is undoubtedly true that consequential damages in product substitution cases are sometimes very large indeed. See, for example, United States u. Roggy, 76 F.3d 189 (8th Cir. 1996), cert. denied, 116 S. Ct. 1700 (1996), in which the defendant defrauded General Mills by promising to spray oats with a pesticide safe

for human consumption and instead spraying the oats (16 million bushels of them) with Dursban, a cheaper pesticide not safe for human consumption. See id. at 191. The damage to General Mills topped $ 80 million, and the Eighth Circuit upheld the trial court's assessment of this amount as the loss under section 2F1.1 against the defendant's argument that the loss should be either the amount he saved by using the cheaper pesticide, or, at worst, the total amount he was paid for his services. See id. at 19394.

Footnote:

285. USSG 2 2F1.1 application note 7(c).

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286. This result is suggested by USSG 2F1.1, Application Note 7(a), which says, "Where, for example, a defendant fraudulently represents that stock is worth $ 40,000 and the stock is worth only $ 10,000, the loss is the amount by which the stock was overvalued (i.e., $ 30,000)." 287. The commentary does not elaborate on what is meant by causation. 288. Section 2F1.1, Application Note 7(b) reads:

In some cases, the loss determined above may significantly understate or overstate the seriousness of the defendant's conduct. For example. . a defendant may understate his debts to a limited degree to obtain a loan (e.g., to expand a grain export business), which he genuinely expected to repay and for which he would have qualified at a higher interest rate had he made truthful disclosure, but he is unable to repay the loan because of some unforeseen event (e.g., an embargo imposed on grain exports) which would have caused a default in any event. In such a case, the loss determined above may overstate the seriousness of the defendant's conduct . . (and a) downward departure may be warranted.

USSG 2F1.1 application note 7(b).

Footnote:

289. Id.

290. See id

Footnote:

291. See supra note 269 and accompanying text 292. USSG 2F1.1 application note 7(b).

Footnote:

293. See, e.g., United States v. Bennett, 60 F.3d 902, 905 (lst Cir. 1995) (rejecting defendant's request for a downward departure based on the claim that the loss was inflated due to an .economic downturn in the regional economy," but recognizing the potential validity of such a claim); United States v. Rostoff, 53 F.3d 398, 405 (lst Cir. 1995) (acknowledging that a downward departure may be warranted in the few instances where "'a misrepresentation . . . is not the sole cause of the loss.'") (quoting USSG 2F1.1 application note 11 (1987)). See also United States v. Irons, 53 F.3d 947, 949 (8th Cir. 1995), an insurance fraud case in which the defendant submitted false claims arising from a staged automobile accident. Insurance companies paid out over $ 221,000. The defendant claimed that real loss was only around $ 50,000 because insurer had paid only $ 50,000 in benefits before a second, genuine collision occurred. The court of appeals rejected the defendant's argument on the ground that the insurer's payments were based on the first accident, not the second. See id. The opinion implicitly conceded that an adjustment might be appropriate in a case of multiple claims where one or more of the nonfraudulent claims were genuine.

294. The Third Circuit reads note 7(b) as creating a rule that: it is not appropriate to reduce the amount of the loss . . in order to reflect other causes of the loss which were beyond the defendant's control. An intervening force that in

Footnote:

creases a fraud-related loss will not decrease the loss valuation but will only provide possible grounds for a downward departure.

United States v. Neadle, 72 F.3d 1104, 1110 (3d Cir. 1995) (relying on United States v. Kopp, 951 F.2d 521, 531 (3d Cir. 1991)), cert. denied, 117 S. Ct. 238 (1996). 295. USSG 1B1.3(aX3).

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296. United States v. Marlatt, 24 F.3d 1005, 1007 (7th Cir. 1994). 297. See supra notes 21-22 and accompanying text.

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298. Neadle, 72 F.3d at 1119 (Becker, J., concurring and dissenting) (citing 4 FOWLER V. HARPER ET AL., THE LAW OF TORTS 20.2, at 89-91 (2d ed. 1986)). 99 TTll: S 1R1 R 1 sAtrt Y.R1

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300. As Benjamin Franklin observed, "A little neglect may breed great mischief... (F)or want of a nail the shoe was lost, for want of a shoe the horse was lost, and for want of a horse the rider was lost." BENJAMIN FRANKLIN, POOR RICHARD'S ALMANAC, Preface: Courteous Reader (1758) (quoting GEORGE HERBERT, JACULA PRUDENTUM, no. 499 (1651)); see also W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS 41, at 264 (5th ed. 1984) ("In a philosophical sense, the consequences of an act go forward to eternity, and the causes of an event go backward to the dawn of human events, and beyond.").

301. See, e.g., KEETON ET AL., supra note 300, 42, at 279 (discussing the "fruitless quest for a universal formula" for proximate cause).

Footnote:

302. See id. 42, at 278 (citing Jeremiah Smith, Legal Causes in Actions of Tort, 25 HARV. L. REv. 103, 223, 229 (1911)).

303. The substantial factor test was adopted as a test for proximate cause by the original Restatement of Torts. In subsequent revisions, the Restatement limited its application to causein-fact. See KEETON ET AL., supra note 300, 42, at 278.

Footnote:

304. The phrase "proximate cause" immediately calls to the mind of any Anglo-American lawyer the unlikely series of catastrophes described in law school chestnuts like Palsgraf v. Long Island Railroad, 162 N.E. 99 (N.Y. 1928), in which a railroad employee trying to help a passenger board a train knocked a package containing fireworks from the passenger's arms, whereupon they exploded, causing a concussion which knocked over scales some distance away on the platform, which in turn injured the plaintiff, and In re Polemis and Furness, Withy & Co., 3 K.B. 560 (Eng. C.A. 1921), in which a plank dropped by a defendant's workman into the hold of a ship struck a spark, which ignited gasoline vapors causing an explosion and fire that destroyed the ship. Even though Judge Cardozo found no liability in Palsgraf, and the Privy Council in The Wagon Mound,

(1961) App. Cas. 388 (P.C. 1961), overruled the finding of liability in Polemis, the general perception is that, as a limitation on liability, proximate cause is next to no limitation at all.

Footnote:

305. See generally KEETON ET AL., supra note 300, 7, at 31-32 (identifying three categories of tort).

306. See id. 3 30, at 164-65. 307. See id. 43, at 280.

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308. See supra note 246 and accompanying text.

309. Of course, there is also dispute over the definition of what is foreseeable within torts and contracts, but the subtleties of those definitional conflicts are beyond the scope of this Article

310. See, e.g., East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 866, 869, 871-72 (1986) (holding admiralty law incorporates principles of product liability, and noting that the assessment of liability for defective products in torts is justified by policy considerations of cost-shifting, promotion of product safety, and encouragement of insurance). See generally KEETON ET AL., supra note 300, 4, at 20-21 (discussing factors affecting tort liability).

Footnote:

311. See MURRAY, JR., supra note 234, at at 219-24.

312. See Exxon Co., U.S.A. v. Sofec, Inc., 517 U.S. 830, 116 S. Ct. 1813, 1819 (1996) ("(T)he requirement of foreseeability may be more stringent in the context of contract liability than it is in the context of tort liability."). 313. 156 Eng. Rep. 145 (Ex. 1854).

314. See generally Paul K Ryu, Causation in Criminal Law, 106 U. PA. L. REV. 773, 773 (1958) ('(T)he problem of causation has received scant attention in Anglo-American criminal law literature.").

Footnote:

315. "The notion of causation runs throughout the law-including the criminal law-and it is generally understood to encompass two concepts. A defendant's conduct must generally be both the 'cause in fact' and the 'proximate cause' of some harm before liability is imposed." United States v. Neadle, 72 F.3d 1104, 1119 (3d Cir. 1996) (Becker, J., concurring and dissenting).

316. See, e.g., MODEL PENAL CODE 2.02(2)(d) (1962) (defining criminal negligence to require that defendant should have been aware of a substantial and unjustifiable risk of harm). 317. See, e.g., Henderson v. Kibbe, 431 U.S. 145, 156-57 (1977) (finding foreseeability of death a necessary component of depraved indifference murder under New York law); Regina v. Cunningham, 2 Q.B. 396 (1957) (holding that "malice" under the Offenses against the Person Act, 1861, embraces both intentional and reckless conduct, and recklessness requires evidence that defendant foresaw the threatened injury).

Footnote:

318. See, e.g., People v. Rakusz, 484 N.Y.S.2d 784, 786 (N.Y. Crim. Ct. 1985) (finding defendant guilty of assault, defined as causing injury to a police officer "(w)ith intent to prevent . . . (him) from performing a lawful duty," when an officer frisking a struggling defendant cut his hand on a knife, because the injury was foreseeable to defendant) (quoting N.Y. PENAL LAW 120.05(3)); State v. Williquette, 385 N.W.2d 145, 150

(Wis. 1986) (holding that a defendant "subjects a child" to abuse if, by act or omission, "she causes the child to come within the influence of a foreseeable risk of cruel maltreatment").

319. See Pinkerton v. United States, 328 U.S. 640, 647-48 (1946); see also United States v. Laurenzana, 113 F.3d 689, 693 (7th Cir. 1997) (finding defendant guilty of conspiracy to commit mail fraud where he entered scheme in which it was reasonably foreseeable that U.S. Mail would be used).

Footnote:

320. People v. Croy, 710 P.2d 392, 398 n.5 (Cal. 1985). See generally DRESSLER, supra note 62, 30.05(B)(5), at 443 (discussing natural-and-probable-cause-consequences doctrine).

321. Some jurisdictions apply the felony murder rule to all deaths caused in fact by the commission of designated dangerous felonies, on the theory that such felonies always present a particular risk of death. See LAFAvE & SCoTT, JR., supra note 27, 7.5(b), at 624-25. Other jurisdictions impose a specific requirement that the death in the particular case have been a foreseeable outcome of the defendant's felony. See id. 7.5(d), at 626-27.

322. See supra note 229 and accompanying text (discussing section lBl.3(a) which dictates that sentencing be based on harms resulting from the foreseeable conduct of defendant's criminal partners); supra Part IV.A.4 (discussing section 2F1.1, application note 7(c), including in "loss" foreseeable consequential damages in procurement fraud and product substitution cases); see also USSG 2Fl.1 n.10(a) (authorizing a departure for "reasonably foreseeable nonmonetary harm"), id. ' 2F1.1 n.10(c) (authorizing departure for "reasonably foreseeable" physical, psychological, or emotional harm). Cf. United States v. Sarno, 73 F.3d 1470 (9th Cir. 1995) (finding all losses on fraudulently procured loan attributable to the defendant even where the default was not his fault because it was reasonably foreseeable from the defendant's conduct that the loan would be approved, putting the bank's money at risk). 323. 501 U.S. 808 (1991).

Footnote:

324. Id. at 818 (quoting Booth v. Maryland, 482 U.S. 496, 504, 505 (1987)). 325. See id. at 838-39 (Souter, J., concurring). In dissent, Justice Stevens tacitly conceded that impact on surviving victims would be relevant if foreseeable. He simply argued that the majority's holding

permits a jury to sentence a defendant to death because of harm to the victim and his family that the defendant could not foresee, which was not even identified until after the crime had been committed, and which may be deemed by the jury, without any rational explanation, to justify a death sentence in one case and not in another. Id. at 863 (Stevens, J., dissenting).

Footnote:

326. The definition of "foreseeability" suggested here draws on Professor Corbin's statement of the modern rule governing the recoverability of consequential damages arising from special circumstances. He wrote:

All that is necessary, in order to charge the defendant with a particular loss, is that it is one that ordinarily follows the breach of such a contract in the usual course of events, or that reasonable men in the position of the parties would have foreseen as a probable resuit of the breach.

Footnote:

CORBIN, supra note 246, 1010, at 79.

327. I have argued elsewhere that, in contrast to narcotics sentences, economic crime sentences under the Guidelines are "often too short in relation to their moral seriousness, in relation to the harm they cause, and in relation to the investment of resources required to prosecute them." Bowman, supra note 10, at 740.

Footnote:

328. See, e.g., United States v. Newman, 6 F.3d 623, 630 (9th Cir. 1993) (expressing concern that calculation of "consequential damages for arson or theft in insurance fraud case would be too complex). 329. See supra notes 199-229.

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330. See, e.g., Carol C. Lam, Assessing Loss in Heath Care Fraud Cases, 10 FED. SENTENCING REP. 145, 147 (Nov.-Dec. 1997) ("It is, of course, logistically impossible to prove widespread fraud on a patient-by-patient, claim-by-claim basis in a medical practice that had thousands of patients, each of whom received multiple services."). 331. See Appendix A, Proposed 221.1 application note l(d). 332. USSG 2 2B1.1 application note 2. 333. See supra notes 208-11 and accompanying text.

Footnote:

334. USSG 2F1.1 application note 7, construed in United States v. Moored, 38 F.3d 1419, 1423 (6th Cir. 1994) (stating in dictum that loss does not include interest).

335. See United States v. Gilberg, 75 F.3d 15, 17 (lst Cir. 1996) (including accrued mortgage interest in loss of $ 726,637, and distinguishing section 2F1.1, application note 7, on the ground that accrued mortgage interest is not "opportunity cost" interest), relying on United States v. Goodchild, 25 F.3d 55, 65-66 (lst Cir. 1994) (holding accrued finance charges on credit cards are not opportunity cost interest and therefore may be included in loss); United States v.

Footnote:

Henderson, 19 F.3d 917, 928 (5th Cir. 1994) (The) commentary sweeps too broadly and, if applied in this case (a bank fraud case) would be inconsistent with the purpose of (section) 2F1.1... Interest should be included if, as here, the victim had a reasonable expectation of receiving interest from the transaction."); United States v. Allender, 62 F.3d 909, 917 (7th Cir. 1995) (distinguishing between interest a defendant specifically agrees to pay by contract and "speculative 'opportunity cost' interest"), overruling United States v. Clemmons, 48 F.3d 1020 (7th Cir. 1995); see also United States v. Jones, 933 F.2d 353, 354-55 (6th Cir. 1991) (finding interest should be included where defendant defrauded credit card companies that had a reasonable expectation of a specific return on the credit extended); United States v. Lowder, 5 F.3d 467, 471 (lOth Cir. 1993) (holding interest should be included where the defendant promised victims a specific interest rate); United States v. Kunzman, 54 F.3d 1522, 1532 (lOth Cir. 1995) (finding that lower court properly determined loss based upon repaid principle without consideration of repaid interest and that lower court properly excluded from loss the interest due investors).

Footnote:

336. See, e.g., United States v. Clemmons, 48 F.3d 1020, 1025 (7th Cir. 1995) ("The degree of certainty with which defrauded investors expected a return on their investments is not, in our opinion, a significant distinction... (F)ailure to receive the promised interest is not a loss at all, but a frustrated expectation."), overruled by United States v. Allender, 62 F.3d 909, 917 n.2 (7th Cir. 1995).

337. See United States v. Henderson, 19 F.3d 917, 928 (5th Cir. 1994) ("Interest should be included if, as here, the victim had a reasonable expectation of receiving interest from the transaction."); Jones, 933 F.2d at 354 ("When (defendant) failed to pay (credit card bills), the issuer lost the use of money that ought to have come back to it."). But cf United States v. Bailey, 975 F.2d 1028, 1030-31 (4th Cir. 1992) (excluding from loss the profits promised by a fraud defendant to his investors).

Footnote:

338. 25 F.3d 55, 66 (lst Cir. 1994). 339. 62 F.3d 909, 917 (7th Cir. 1995).

Footnote:

340. See 28 U.S.C. 1961 (1994) (setting interest on money judgments in civil cases at Za rate equal to the coupon issue yield equivalent (as determined by the Secretary of the Treasury) of the average accepted auction price for the last auction of United States Treasury bills settled immediately prior to the date of the judgment"). 341. See supra Part IV.A

Footnote:

342. See United States v. Flowers, 55 F.3d 218, 220-21 (6th Cir. 1995) (Neither (section) 2B1.1 nor (section) 2F1.1 of the Guidelines addresses the point in time at which actual loss is to be measured.").

343. USSG 2F1.1 application note 7.

Footnote:

344. This point could be reached at the moment the crime is legally complete, at the moment of discovery, at the moment of apprehension of the defendant, at the time of sentencing, or at some time long after sentencing. Picking a time after sentencing as the point at which loss becomes final does not foreclose making the determination of loss at sentencing; it simply requires an explicit recognition that the loss calculation will involve prediction of future events.

345. If we apply the cause-based analysis suggested above to the question of determining the identity of the victim, the fact that an insurance company would have to compensate me for the damages would surely be foreseeable, and thus the company would be a victim and its loss chargeable to the defendant.

Footnote:

346, The Seventh Circuit, for example, is of many minds on the question, having issued opinions endorsing three of the four possible views. Compare United States v. Mount, 966 F.2d 262, 265 (7th Cir. 1992) (time of the crime), with United States v. Downs, 123 F.3d 637, 644 n.2 (7th Cir. 1997) (loss measured at time of discovery in fraudulent loan case), and United States v. Asher, 59 F.3d 622, 624-25 (7th Cir. 1995) (loss in check-kiting scheme measured at time of detection), and United States v. Chevalier, 1 F.3d 581, 585-86 (7th Cir. 1993) (time of sentencing).

Footnote:

347. See USSG 2B1.1 application note 2.

348. See United States v. Copus, 110 F.3d 1529, 1535-36 (lOth Cir. 1997) (where defendant obtained loan legitimately, but later lied to bank inspector about collateral, offense committed at time of lie and loss should be measured as if bank had foreclosed at that time); United States v. Mount, 966 F.2d 262, 266 (7th Cir. 1992) (stating that embezzler causes loss once property taken, despite intent to repay and lack of discovery). The views of the Eighth Circuit are somewhat hard to divine. See United States v. Smith, in which the court considered a

credit card fraud case in which, between discovery and sentencing, some items were recovered from codefendants. 62 F.3d 1073, 1079 (8th Cir. 1995). The court held that the defendant was not entitled to credit for these items. This result could flow from either a rule that the time at which loss should be measured is when the crime is complete or a rule designating the time of discovery. In United States v. Morris, the defendant was convicted of various forms of bank fraud, check-kiting, false statements to obtain loan, etc. 18 F.3d 562, 564 (8th Cir. 1994). During the course of the scheme, but before detection, the defendant arranged for the sum of $ 156,000 to be repaid to the bank to avoid detection of the scheme by bank regulators. See id. at 570. At sentencing, the defendant asked for credit for this amount against the loss. The district court granted the credit; the court of appeals reversed and refused the credit. See id. The Eighth Circuit offered no rationale for this holding, but the holding is consistent with a "time of the crime" rule and inconsistent with a "time of detection" rule.

Footnote:

349. USSG 2F1.1 application note 7(b).

350. See, e.g., United States v. Lucas, 99 F.3d 1290, 1296-97 (6th Cir. 1996) (endorsing time of discovery rule and finding that discovery refers to state of mind of victim or authorities depending upon which party discovers the offense first).

Footnote:

351. See United States v. Fraza, 106 F.3d 1050, 1055 (lst Cir. 1997) (holding loss is amount of fraudulent loan not repaid at time offense was discovered, reduced by the amount the lending institution may recover from assets pledged to secure the loan); United States v. Akin, 62 F.3d 700, 702 (5th Cir. 1995) (rejecting check-kiting defendant's argument that loss should be reduced by restitution payments made after discovery of the offense but prior to sentencing and holding that loss should be measured at time of discovery of scheme); United States v. Asher, 59 F.3d 622, 624-25 (7th Cir. 1995) (finding time for determining loss is time crime is detected); United States v. Flowers, 55 F.3d 218, 220-22 (6th Cir. 1995) (holding in check-kiting case that loss was amount of outstanding bad checks, less any amount in accounts at time of discovery); United States v. Stanley, 54 F.3d 103, 106 (2d Cir. 1995) (finding loss in bond fraud case was amount of devaluation occurring during period between bank officer defendant's misstatements to bank and customers and the time at which fraud was discovered); United States v. Shaffer, 35 F.3d 110, 115-16 (3d Cir. 1994) (holding that loss should be determined when crime is detected); United States v. Frydenlund, 990 F.2d 822, 825-26 (5th Cir. 1993) (rejecting argument that check-kiting should be treated like fraudulently obtained loan and instead measuring loss at time of discovery of scheme); United States v. Bolden, 889 F.2d 1336, 1341 (4th Cir. 1989) (stating that restitution does not justify reducing minimum sentence under the Guidelines although it may be relevant in deciding what sentence within the Guidelines the court should impose).

Footnote:

352. See United States v. Chevalier, 1 F.3d 581, 585-86 (7th Cir. 1993) (finding that loss is "the amount of money the victim has actually lost . . . estimated at the time of sentencing'"); United States v. Kopp, 951 F.2d 521, 536 (3d Cir. 1991) (holding that although actual loss in a fraudulent loan application case should be estimated at the time of sentencing, "the 'loss' should be revised upward to the loss that the defendant intended to inflict, if that amount is higher than actual loss"); see also Stephen V. Manning & Barbara Bailey Jongbloed, Timing of Loss in Secured Loan Cases, 10 FED. SENTENCING REP. 149 (Nov.-Dec. 1997) (arguing that in loan fraud cases loss should be measured at time of sentencing ") (quoting Kopp, 951 F.2d at 536).

Footnote:

353. USSG 2F1.1 application note 7(b).

354. A careful examination of Note 7(b) reveals that it has both "time of detection" and "time of sentencing" components. In making a loss calculation under Note 7(b), the court is asked to begin with "the amount of the loan not repaid at the time the offense is discovered," and then to subtract any amount the bank "has recovered (or can expect to recover) from any assets pledged to secure the loan." Id. The use of the phrase "has recovered" plainly refers to the state of affairs existing at sentencing. The phrase "or can expect to recover" requires the sentencing court to make loss calculations based in part on predictions regarding resolution of future foreclosures and subsequent sales of collateral.

Footnote:

355. See United States v. Smith, 62 F.3d 1073, 1079 (8th Cir. 1995) (finding credit card fraud defendant responsible for total amount of unauthorized charges and giving no credit for items obtained by fraud but later recovered); United States v. Asher, 59 F.3d 622 (7th Cir. 1995) (holding that check-kiting defendant's immediate repayment of $ 160,000 overdraft outstanding at time of discovery does not affect loss figure); United States v. Mau, 45 F.3d 212 (7th Cir. 1995) (arranging a fully collateralized repayment plan after discovery will not reduce loss); United States v. Bean, 18 F.3d 1367, 1369 (7th Cir. 1994) (finding no basis for extraordinary departure when defendant repaid principal of involuntary loan before trial); United States v. Carey, 895 F.2d 318 (7th Cir. 1990) (reversing a district court's downward departure for presentencing restitution, noting that restitution may be relevant to acceptance of responsibility under section 3E1.1, or to a departure under section 5K2.0, if extraordinary, but that district court already considered restitution in awarding two point deduction for acceptance of responsibility and did not present findings or extraordinary circumstances to warrant a further reduction.

Footnote:

But see United States v. Baum, in which the Fourth Circuit seems to have held that payments made on a fraudulently obtained loan after discovery of the fraud but before sentencing should have been credited to the defendants to reduce the loss. 974 F.2d 496, 498-99 (4th Cir. 1992). However, this opinion was written before the November 1992 amendment to USSG section 2F1.1, note 7(b), and therefore may no longer be good law, even in the Fourth Circuit.

356. See United States v. Jackson, 95 F.3d 500, 505-06 (7th Cir. 1996) (holding loss in telemarketing scam equal to amount paid by victims less cost to defendant of goods transferred to victims as part of scheme); United States v. Maurello, 76 F.3d 1304, 1311-12 (3d Cir. 1996)

Footnote:

(holding that defendant convicted of mail fraud for deceiving clients by practicing law without a license should be credited in loss calculation for value of satisfactory legal services rendered); United States v. Licciardi, 30 F.3d 1127, 1134 (9th Cir. 1994) (holding defendant should have been credited with value of wine grapes that were delivered, even though they were misrepresented); United States v. Reddeck, 22 F.3d 1504, 1513 (lOth Cir. 1994) (remanding case to district court for factual findings on value of degrees received by students at defendant's failed and fraudulently operated proprietary school, holding that gross amount of tuition paid for unaccredited degree was not necessarily correct assessment of net loss to student victims without evidence regarding the value of the degrees received); United States v. Gennuso, 967 F.2d 1460, 1461-63 (lOth Cir. 1992) (reducing victims' losses because they received from the defendant the value of the wholesale cost of a water

purification system and a vacation package); United States v. Smith, 951 F.2d 1164, 1167 (lOth Cir. 1991) (decreasing victims' losses because they received from the defendant value in the form of security interests and promises of individual borrowers to repay fraudulently secured loans). But see United States v. Pappert, 104 F.3d 1559, 1567 (lOth Cir. 1997) (refusing to credit defendant in fraudulent equipment lease scheme for value of machines retained by victims where there was evidence that sometimes used machines were represented to be new, some machines were pledged as collateral on multiple leases, and in at least one case, machinery had depreciated to point where cost of repossession exceeded value).

Footnote:

357. 930 F.2d 555, 558 (7th Cir. 1991).

358. After Schneider, Application Note 7(b) was added to the section 2F1.1 commentary. It begins: *In fraudulent loan application cases and contract procurement cases, the loss is the actual loss to the victim (or if the loss has not yet come about, the expected loss)." USSG

2F1.1 application note 7(b). The note makes no further reference to contract procurement cases and gives no explanation of how "actual loss" is to be measured in such cases. Likewise, the note does not define "expected loss." See also United States v. Stern, 13 F.3d 489, 496-98 (lst Cir. 1994) (suggesting that when contractor uses phony bond to obtain a contract, the court may estimate loss as the cost of a valid performance bond). 359. 73 F.3d 331 (llth Cir. 1996).

Footnote:

360. See id. at 334.

361. Id. The court rejected the defendant's argument for using "net loss" to the victims as a group, because such an approach "focuses on the gain to the defendant, which ordinarily underestimates the loss." Id (citing USSG 2F1.1 application note 8).

Several courts have held that Ponzi scheme defendants are entitled to no credit against loss for any repayment made to victims. See United States v. Loayza, 107 F.3d 257, 265-66 (4th Cir. 1997) (refusing to reduce loss by amounts paid to early investors in fraud scheme); United States v. Carrozzella, 105 F.3d 796, 805 (2d Cir. 1997) (same); United States v. Dobish, 102 F.3d 760, 762-63 (6th Cir. 1996) (holding amount returned to victims as "profits" to maintain investor confidence not deductible from loss); United States v. Mucciante, 21 F.3d 1228, 1237-38 (2d Cir. 1994) (holding amounts paid to maintain confidence of Ponzi scheme investors could not be used to reduce loss).

Footnote:

362. USSG 2F1.1 application note 7(b). In United States v. Channapragada, the Seventh Circuit raised the question of what section 2F1.1, Application Note 7, means by "assets pledged to secure the loan." 59 F.3d 62, 66-67 (7th Cir. 1995). In that case, the defendant gave a personal guarantee of all his personal assets as a condition of the four loans at issue. After the crime was complete, and after discovery but before sentencing, the defendant acquired some stock. See id. at 66. He claimed the value of the stock should be offset against the loss. See id. The defendant relied on language in United States v. Mount, in which the court suggested in dictum that loss should be reduced where the victim has *access to a ready source of compensation." Channapragada, 59 F.3d at 66 (quoting United States v. Mount, 966 F.2d 262, 266 (7th Cir. 1992)). The Seventh Circuit denied the offset, stating, "unrealized plans to repay do not reduce the loss amount."' Id. at 67 (citing United States v. Holiusa, 13 F.3d 1043, 1046 (7th Cir. 1994)). Channapragada reached the right result via the wrong route. The important point was that the stock was not among the defendant's assets when he fraudulently induced the

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lenders to make the loans. See id. at 66. The focus should be on the defendant's state of mind at the time of the crime, and the economic facts at the time of the crime.

363. See, e.g., United States v. Brewer, 60 F.3d 1142, 1145 (5th Cir. 1995) (holding district court had discretion to refuse to subtract the proceeds of an auction by the bank of property acquired with the fraudulent loan, and that it is "proper to calculate loss based on the risk engendered by the defendant's criminal conduct, even where the actual loss was lower") (citing United States v. Wimbish, 980 F.2d 312, 316 (5th Cir. 1992)); see also United States v. Norris, 50 F.3d 959, 961 (llth Cir. 1995) (where repayments were made after detection, holding that a district court that uses Application Note 7(b) should consider repayments, but declining "to hold, that repayments can never be included in loss"); United States v. Sheahan, 31 F.3d 595, 602-03 (8th Cir. 1994); United States v. Morris, 18 F.3d 562, 570 (8th Cir. 1994) (finding that the loss calculation "did not turn on whether (the bank) recovered or could have recovered its potential loan losses by foreclosing on the pledged security").

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364. See, e.g., United States v. Chorney, 63 F.3d 78, 83 (lst Cir. 1995) ("To give the defendant credit for other, unpledged assets is simply a free ride for the wealthy defendant and wholly at odds with the underlying purpose of the guideline."); see also United States v. Rothberg, 954 F.2d 217, 219 (4th Cir. 1992) (holding in case concerning damages that could be recovered by the victim in a civil proceeding that assets other than collateral which a bank may recover are "akin to restitution and (are) not a proper consideration in determining the loss suffered as a result of the fraud"). Accord United States v. Eliassi, No. CR-93-110, 1995 WL 44656, at *3 (4th Cir. Feb. 1, 1995) (holding that "assets other than collateral that a bank may recover 'is akin to restitution and is not a proper consideration in determining the loss suffered as a result of the fraud") (quoting United States v. Rothberg, 954 F.2d 217, 219 (4th Cir. 1992)). 365. 60 F.3d 240 (6th Cir. 1995).

366. See id. at 242-43 (Batchelder, J., dissenting).

Footnote:

367. See id. (Batchelder, J., dissenting). 368. See id. at 241-42.

Footnote:

369. Its explanation for doing so was that the use of the word "pledge" in the commentary distorts the meaning of the guideline. See id. at 241. Presumably, the court meant that the use of the unadorned term "los" in the guideline restricts the concept to the final economic harm suffered by the victim after all civil or criminal recoveries, foreclosures, and offsets. The court cited Stinson v. United States, 508 U.S. 36 (1993), for the proposition that because of the perceived conflict it could ignore the plain language of the commentary. See Wright, 60 F.3d at 241-42.

370. Wright, 60 F.3d at 242.

Footnote:

371. The panel's opinion in Wright is followed by the persuasive dissent of Judge Batchelder, who found no inconsistency between the text of section 2F1.1 and the example in application note 7(b). See id. at 243 (Batchelder, J., dissenting). Judge Batchelder noted that the set off against the deposit account had no fixed value (because the amount in the account could be changed at the whim of the defendant), distinguished the Sixth Circuit cases cited by the majority, and chided the majority for focusing purely on the harm to the victim

as opposed to the severity of the criminal act. See id. at 243-44 (Batchelder, J., dissenting). Finally, she noted that the majority's approach to fraudulent loan application cases "has loaded the scales in favor of the wealthy.' Id. at 244 (Batchelder, J., dissenting). 372. 99 F.3d 1290,1299 (6th Cir. 1996).

Footnote:

373. See id. at 1298-99. 374. See USSG 1B1.3(a)(1)(B).

375. See United States v. Akin, 62 F.3d 700, 701 (5th Cir. 1995) (holding loss in checkkiting case to be measured at time of detection, and rejecting defendant's argument that the loss figure should be reduced by restitution payments made between time of discovery of check-kite and sentencing); United States v. Asher, 59 F.3d 622, 624-25 (7th Cir. 1995) (holding amount of loss in check-kiting scheme is amount of overdraft measured at the time of discovery of the scheme); United States v. Flowers, 55 F.3d 218, 220-22 (6th Cir. 1995) (holding loss in checkkiting case is amount of outstanding bad checks less any amount in accounts at time of discovery); United States v. Mau, 45 F.3d 212, 215-16 (7th Cir. 1995) (holding amount of loss in checkkiting scheme is amount of overdraft measured at the time of discovery of the scheme); United States v. Frydenlund, 990 F.2d 822, 825-26 (5th Cir. 1993) (rejecting argument that check-kiting should be treated like fraudulently obtained loan and instead measuring loss at time of discover of scheme).

Footnote:

Implicit in this result is the holding that the defendant will not be held responsible for larger overdrafts that existed earlier in the scheme, but which were paid back before discovery. This rule might be thought to stem from the idea that the loss in a kiting scheme would only be measurable at its conclusion, but in truth the net overdraft could be measured at any point in the course of the scheme by a retrospective review of the records. 376. 18 F.3d 562 (8th Cir. 1994). 377. See id. at 564.

Footnote:

378. See id. at 570. The Eighth Circuit offered no explanation for this result other than to say, "We believe that the district court's exclusion of the $ 156,000 from the loss calculation resulted from an erroneous interpretation of (section) 2F1.1 and our prior cases." Id. 379. 993 F.2d 1358, 1358-59 (8th Cir. 1993).

380. See id. The holding was apparently based on the theory that there was no "taking" as to the larger sum. The problems flowing from the use of the term "taken" in section 2B1.1, Application Note 2, are discussed below in Part III.B.1. See also supra notes 195-98 and accompanying text.

Footnote:

381. 961 F.2d 1012, 1017 (lst Cir. 1992), cited with approval in United States v. Johnson, 993 F.2d 1358, 1359 n.2 (8th Cir. 1993). 382. 981 F.2d 281, 284-86 (7th Cir. 1992).

383. 951 F.2d 522, 530 n.13 (3d Cir. 1991) (stating that '(i)n that case intended loss would be zero and actual loss might also be zero").

384. The court says that, "embezzlement, unlike ordinary theft or fraud, involves not only a taking but also an action akin to a breach of fiduciary duty, which might justify always using the amount taken as loss'." Id.

See also United States v. Mount, in which the defendant stole baseball playoff tickets with a face value of $ 12,000 and sold them in a block to a scalper for $ 30,000. 966 F.2d 262, 266 (7th Cir. 1992). In order to cover up the theft, the defendant planned to deposit $ 12,000 into the baseball team's account; presumably, the money would come from the sale to the scalper. The

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court suggested that the defendant's intention to repay (and perhaps even whether he did repay) was irrelevant: "An embezzler who abstracts $ 10,000 to invest in the stock market causes a 'loss' of $ 10,000 even if he plans to repay before the next audit (to avoid detection) and even if he invests only in blue chip stocks." Id.

Footnote:

385. See generally HALL, supra note 21, at 185-90.

Footnote:

386. See Braverman v. United States, 317 U.S. 49, 53 (1942) (The overt act . . . need not be itself a crime."). See generally LAFAVE & SCOTT, JR., supra note 27, 6.5(c), at 547-49. 387. See 18 U.S.C. 1341, 1343 (1994).

388. See supra note 351 and accompanying text. Note that the Seventh Circuit is included in this total, and it has used a variety of time-of-measurement rules. See supra note 346.

Footnote:

389. See Appendix A, Proposed 221.1 application note Ug). 390. See, e.g., United States v. Wright, 60 F.3d 240 (6th Cir. 1995), discussed supra note 365 and accompanying text.

391. 73 F.3d 331 (llth Cir. 1996), discussed supra notes 359-61, and accompanying text. 392. For cases adopting this approach, see supra note 361.

Footnote:

393. See USSG 2F1.1 application note 7 ("(I)f an intended loss that the defendant was attempting to inflict can be determined, this figure will be used if it is greater than the actual loss."). In general, the courts have complied. See, e.g., United States v. Smith, 62 F.3d 1073, 1079 (8th Cir. 1995) (holding credit card fraud defendant responsible for total amount of unauthorized charges, granting no credit for items obtained by fraud but later recovered); United States v. Alonso, 48 F.3d 1536,1547 (9th Cir. 1995) (holding in credit card fraud case that loss

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equals greater of actual or intended losses); United States v. Mizrachi, 48 F.3d 651, 657 (2d Cir. 1995) (upholding district court's use of intended loss in amount of face value of policy taken out by defendant on property he burned); United States v. Chevalier, 1 F.3d 581, 585-86 (7th Cir. 1993) (stating that loss is calculated at time of sentencing, but revised upward if the defendant intended to inflict loss greater than that actually inflicted); United States v. Watkins, 994 F.2d 1192, 1196 (6th Cir. 1993) (formulating test for when a defendant is responsible for intended loss); United States v. Kopp, 951 F.2d 521, 536 (3d Cir. 1991) ("'(L)oss' is. . the amount of money the victim has actually lost (estimated at the time of sentencing), not the potential loss as measured at the time of the crime. However, the loss' should be revised upward to the loss that the defendant intended to inflict. if that amount is hieher than actual loss.").

Footnote:

394. One of the notable textual differences between the two guidelines is that section 2F1.1, Application Note 7, provides for use of "intended loss" if greater than "actual loss," USSG

2F1.1 application note 7, while section 2Bl.1 defines loss as the "value of the property taken," and does not refer to "intended loss." USSG 2B1.1 application note 2. This difference has been the source of some confusion,

but the courts count intended loss, if greater, even in many theft cases. See, e.g., Kopp, 951 F.2d at 530-31 (holding intended loss, if higher than actual loss, is the proper measure in theft case because, "in a theft case, the thief intends to steal whatever he or she takes; the amount taken is the loss the defendant intended to inflict... In a theft case, unlike a fraud case, the amount taken (the intended loss) is always as high or higher than the amount the victim actually lost (which may be reduced due to fortuitous recovery of the stolen property)."); United States v. Offiong, Nos. 95-50179, 95-50247, 1996 WL 195547 (9th Cir. Apr. 23, 1996) (applying section 2B1.1, application note 4, presumption of $ 100 per credit card intended loss in stolen credit card case); United States v. Sowels, 998 F.2d 249, 251 (5th Cir. 1993) (affirming determination that loss equalled combined credit limits of stolen cards); United States v. Chapdelaine, 989 F.2d 28, 35 (lst Cir. 1993) (applying intended loss in an attempted robbery case, and quoting section 2X1.1, application note 2, which states that, "(i)n an attempted theft, the value of the items the defendant attempted to steal would be considered"); United States v. Hernandez, 952 F.2d 1110, 1118-19 (9th Cir. 1991) (holding intended loss an appropriate component of sentencing calculation for tape counterfeiting defendant sentenced under section 2B1.1); see also United States v. Falcioni, 45 F.3d 24, 26 (2d Cir. 1995) (holding that defendant who acted as middleman in an attempt to bribe IRS employee to relieve codefendant of $ 41,000 tax liability intended tax loss of $ 41,000). But see United States v. Redlin, 983 F.2d 893, 896 (8th Cir. 1993) (suggesting that intended loss may not be part of calculation under section 2B1.1).

Footnote:

395. For a general discussion of the rationale of the law of attempt, see Richard Buxton, The Working Paper on Inchoate Offenses: (1) Incitement and Attempt, 1973 CRIM. L. REv. 656, 660 (1973) ("We have a law of Attempt because persons who threaten to commit acts forbidden by the substantive criminal law should be open to social prevention and deterrence, since such person is, by reason of their intentions, socially dangerous.'). 396. USSG 2F1.1 application note 7.

397. See United States v. Studevent, 116 F.3d 1559, 1562-64 (D.C. Cir. 1997) (rejecting defendant's argument that actual loss is the dominant focus of the Guidelines, and thus that there should be an impossibility limitation on intended loss on the ground that "(o)ne of the Guidelines' eoals is to tailor punishment to a defendant's particular degree of culpability").

Footnote:

398. Criminal liability for conspiracy requires evidence of some fixity of purpose in the form of an agreement with one or more co-conspirators, see United States v. James, 528 F.2d 999, 1011 (5th Cir. 1976), DRESSLER, supra note 62, 29.04(A), at 397, and an overt act in furtherance of the conspiracy committed by one of the conspirators. See United States v. Offutt, 127 F.2d 336, 338 (D.C. Cir. 1942). Attempt liability, customarily requires the commission of a .substantial step" toward accomplishment of the criminal goal. See MODEL PENAL CODE 5.01(2) (1980); see also Buxton, supra note 395, at 660: The law of Attempt . . limits its deterrent and preventive role in the interests of freedom by requiring action, of some sort, as well as intention, on the part of the accused; in the same way as in substantive crime the deterrent and preventive role of the law is to some degree limited by the requirement of in.ens rea.

Footnote:

399. See Studevent, 116 F.3d at 1563 ("Limiting intended loss to that which was likely or possible . . . would eliminate the distinction between a defendant whose only ambition was to make some pocket change and one who plotted a million-dollar fraud.").

400. See, e.g., United States v. Egemonye, 62 F.3d 425, 429 (lst Cir. 1995) (considering but not resolving question of whether subjective or objective standard of intent should be used because sufficient evidence was in record to support finding subjective intent); United States v. Quaye, 57 F.3d 447, 448-49 (5th Cir. 1995) (remanding for finding on whether defendant subjectively intended to repay loan); United States v. Falcioni, 45 F.3d 24, 27-28 (2d Cir. 1995) (holding actual knowledge of amount of "intended" loss was not necessary, implying the record was sufficiently clear that no finding was needed); United States v. Moored, 38 F.3d 1419, 1425 (6th Cir. 1994); see also United States v. Shaw, 3 F.3d 311, 314 (9th Cir. 1993), (holding that, under the 1989 Guidelines, loss in fraudulent loan case was the unpaid balance of a loan minus the amount the defendant subjectively intended to repay). It is questionable whether Shaw remains good law in light of subsequent amendments to section 2Fl.1. 401. See, for example, United States v. Hill, which stated:

Footnote:

When reviewing the calculation of an intended loss, we look to actual, not constructive, intent, and distinguish between cases in which "the intended loss for stolen or fraudulently obtained property is the face value of that property" and those in which the intended loss is zero because "the defendant intends to repay the loan or replace the property."

42 F.3d 914, 919 (5th Cir. 1995) (citing United States v. Henderson, 19 F.3d 917, 928 (5th Cir. 1994)).

In a regime based on constructive intent, the government's obligation would be to show the likely effects of the scheme and ask the court to infer from those likely effects the defendant's subjective intent. See United States v. Stern, 13 F.3d 489, 497 (lst Cir. 1994) ("In this case, the potential was not realized but it was still intended or reasonably likely and thus a proper measure of loss under the guideline.").

Footnote:

402. 930 F.2d 555, 558 (7th Cir. 1991). 403. See Hill, 42 F.3d at 918; Quaye, 57 F.3d at 448. 404. 24 F.3d 1110, 1112 (9th Cir. 1994).

405. The precedential value of Yellowe is somewhat diluted by the fact that the district court and the court of appeals were able to sidestep the full force of the defendant's argument because of the existence of a specific guideline provision for credit card fraud, section 2B1.1, Application Note 4, which provides that the loss in such cases " 'includes any unauthorized charges made with stolen. credit cards, but in no event less than $ 100 per card.' Id. (citing USSG 2B1.1 application note 4). Said the court, "Application Note 4 says nothing about probabilities; rather, it presumes $ 100 per unauthorized credit card number." Id. at 1113.

Footnote:

406. See, e.g., United States v. Studevent, 116 F.3d 1559,1561 (D.C. Cir. 1997) (loss calculation includes stolen checks passed to undercover FBI agent despite fact they would never be cashed); id. at 1110 (applying intended loss provision of section 2F1.1 where defendant entered into a scheme with a government informant to make unauthorized credit card charges); United States v. Robinson, 94 F.3d 1325, 1329 (9th Cir. 1996) ("There is no reason why defendants caught as a result of a sting operation should be treated any differently than defendants caught participating in an ongoing fraud."); United States v. Falcioni, 45 F.3d 24, 27 (2d Cir. 1995) ("Simply because the government's crime prevention efforts prove successful. . . does not mean that the 'intended loss' is zero.").

407. 20 F.3d 1054, 1058-60 (lOth Cir. 1994); accord United States v. Sneed, 34 F.3d 1570 (lOth Cir. 1994).

Footnote:

408. 977 F.2d 517, 519 (lOth Cir. 1992). 409. See id. at 524. 410. Id.

411. See Galbraith, 20 F.3d at 1058.

Footnote:

412. See infra Part V.E. 413. See MODEL PENAL CODE 2.04(IHa).

414. See id. 2.04(2), 5.01(1Xc); see also United States v. Thomas, 13 C.M.A 278-291, 32 C.M.R. 278-291 (1962) (finding servicemen guilty of attempted rape of deceased woman with whom they had intercourse where they erroneously believed her to be alive but unconscious at the time of the act). But see United States v. Berrigan, 482 F.2d 171, 173, 189 (3d Cir. 1973) (reversing convictions for sending letters into and out of a federal penitentiary "without the knowledge and consent of the warden" because, unbeknownst to defendants, their courier had the warden's consent to carry the letters).

Footnote:

415. The Tenth Circuit's Galbraith opinion suggests that a defendant can be sentenced based on the amount of nonexistent narcotics he attempted to buy from a government agent, but not on the amount of money he attempted to swindle from the same agent. The Ninth Circuit noted this anomaly in United States v. Robinson, 94 F.3d 1325, 1329 (9th Cir. 1996), and cited it as a reason to reject the impossibility argument regarding intended loss.

Footnote:

416. USSG 2F1.1 application note 10.

417. United States v. Studevent, 116 F.3d 1559,1563 (D.C. Cir. 1997). 418. 994 F.2d 1192 (6th Cir. 1993). 419. 951 F.2d 1164 (lOth Cir. 1991). 420. Id. at 1168 (emphasis added).

Footnote:

421. For an excellent discussion of the economic reality doctrine, see John D. Cline, Should the Sentencing Commission Adopt the Economic Reality Doctrine?, 10 FED. SENTENCING REP. 141,141-42 (Nov.-Dec. 1997) (concluding that the current fraud guideline "does not include the economic reality doctrine," but arguing that the doctrine should be incorporated in any new economic crime guideline).

422. USSG 2F1.1 app. note 7 (1990). See, e.g., United States v. Dozie, 27 F.3d 95, 99 (4th Cir. 1994) (affirming district court's use of "economic reality" to limit fraud loss calculation, and relying on reference in former version of section 2Fl.1, application note 7, to "probable or intended loss").

Footnote:

423. See USSG App. C, amend. 393 at 221-22 (Nov. 1, 1991). 424. In United States v. Egemonye, the First Circuit upheld the district court's assessment of loss in a stolen credit card scheme as the aggregate credit limits of all the stolen cards, saying, somewhat equivocally: "Where there is good evidence of intent and some prospect of success, we do not think that a court needs to engage in more refined forecasts of just how successful the scheme was likely to be." 62 F.3d 425, 429 (lst Cir. 1995).

Footnote:

425. 51 F.3d 92 (7th Cir. 1995). 426. See id. at 94.

427. Id. at 93 (quoting 18 U.S.C. 2320(a) (1994)). 428. See id. at 94. 429. See id. at 95. 430. Id. at 95. 431. Id. at 96.

Footnote:

432. 94 F.3d 330, 336 (7th Cir. 1996), cert. denied, 117 S. Ct. 1426 (1997). 433. United States v. Lorenzo, 995 F.2d 1448, 1460 (9th Cir. 1993); see also United States v. Jacobs, 117 F.3d 82, 94-98 (2d Cir. 1997) (upholding face amount of fraudulent bank drafts as loss despite very small risk that drafts would actually be honored); United States v. Studevent, 116 F.3d 1559, 1561-62 (D.C. Cir. 1997) (intended loss need not be realistically possible); United States v. Wai-Keung, 115 F.3d 874, 877 (llth Cir. 1997) (same); United States v. Ismoila, 100 F.3d 380, 396 (5th Cir. 1996) ("The fact that the victims were not at risk for the charges above their credit limit is not dispositive.").

Footnote:

434. USSG 2F1.1 application note 7. 435. See supra text accompanying notes 394-97. 436. See, e.g., United States v. Egemonye, 62 F.3d 425, 429 (lst Cir. 1995). 437. See United States v. Watkins, 994 F.2d 1192, 1195 (6th Cir. 1993) ("(F)or intended loss to be deemed relevant under application note 7 to section 2F1.1, the defendant's conduct must meet the requirements of section 2X1. l(bN 1)."). 438. See United States v. Yusufu, 63 F.3d 505, 513 (7th Cir. 1995). 439. See, e.g., United States v. Sung, 51 F.3d 92, 95 (7th Cir. 1995) (applying section 2F1.1 Application Note 7 cross-reference to section 2Xl.1 to impose requirement of economic reasonableness on losses in product counterfeiting case).

Footnote:

440. James Gibson, Attorney Advisor to Sentencing Commissioner Michael Goldsmith, has argued that the proper measure of loss is not the greater of actual or intended loss, but the average of actual and intended loss, regardless of which is greater. See James Gibson, How Much Should Mind Matter? Mens Rea in Theft and Fraud Sentencing, 10 FED. SENTENCING REP. 136 (Nov.-Dec. 1997).

Footnote:

441. See supra note 187 and accompanying text.

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The Tax Adviser
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HEADLINE: Selling a principal residence after the TRA '97; Taxpayer Relief Act of 1997

BYLINE: Adkins, Neil; Grisler, Gregory G.; Thompson, Steven C.

BODY:

Congress has cleaned house in the Taxpayer Relief Act of 1997, by repealing the Sec. 1034 residence sale gain deferral provisions and the Sec. 121 $ 125,000 gain exclusion for taxpayers age 55 and older. Instead, there is now an opportunity to exclude up to $ 250,000 of gain ($ 500,000 if married filing jointly) on the sale of a personal residence, as often as every two years. This article explains the now provisions and offers planning strategies.

After nearly half a century, Congress has remodeled the tax rules for homeowners who plan to sell a principal residence. The Taxpayer Relief Act of 1997 (TRA '97), Section 312(b), repealed the Sec. 1034 rollover provisions, which allowed taxpayers to defer the gain on a sale or exchange of a principal residence to the extent the sales proceeds were reinvested in a new residence. TRA '97 Section 312(a) repealed the Sec. 121 once-in-a-lifetime $ 125,000 gain exclusion on the sale of a principal residence for taxpayers age 55 and over. Sec. 121 (b), as amended, permits individuals meeting ownership and use tests to exclude from taxable income up to $ 250,000 of gain ($ 500,000 if married filing jointly) each time they sell or exchange their principal residence.

Many taxpayers will benefit greatly from these changes; the tax consequences on the sale of a principal residence will be eliminated for nearly 99% of all Americans selling their homes.(1) Thus, taxpayers who move to a less expensive home, relocate to a less costly area or decide to rent may no longer be required to recognize gain on the sale of their personal residences. Other taxpayers will find little or no tax benefit under the TRA '97 on the sale of their principal residences (e.g., homeowners experiencing a loss on sale). Homeowners with gains in excess of the exclusion amounts, and those using their principal residence in part as a rental or business property, will no longer find favorable deferral provisions in the Code. However, the TRA '97 does create a category of transition taxpayers who can choose between applying (1) pre-TRA '97 Sec. 1034 or 121 and (2) post-TRA '97 Sec. 121.

This article explores the TRA '97 provisions, explains the rules for certain transition taxpayers under the new law, and provides planning suggestions for maximizing the tax benefits associated with the sale of a principal residence.

Prior Law

Pre-TRA '97 Secs. 121 and 1034 required careful navigation to maximize the gain deferral or exclusion.(2) Generally, Sec. 1034(a) allowed for gain nonrecognition on the sale of a principal residence, if (1) the purchase

price of the new residence was at least as much as the adjusted sales price of the old and (2) the new residence was occupied by the taxpayer beginning within two years before and ending within two years after the sale of the old residence. Any gain not recognized under Sec. 1034 reduced the taxpayer's basis in the new residence under Sec. 1034(e).

Pre-TRA '97 Sec. 121 allowed a taxpayer age 55 or older, to exclude from gross income up to $ 125,000 of the gain realized on the sale of a principal residence, as long as the residence was used as his principal residence for at least three of the five years immediately before the sale. This election was available to a taxpayer only once during his life. Because Sec. 121(c) required married couples to make the election jointly, this provision often created complex and inequitable predicaments for widowed or divorced senior citizens who desired to remarry and one of the new partners had previously made the election with a former spouse.

The TRA '97

In general, the new Sec. 121 exclusion is allowed for each sale or exchange of a principal residence that has been treated as a principal residence for at least two of the preceding five years. The taxpayer must have owned and used the property as his principal residence for at least two years during the five-year period ending on the date of the sale or exchange ("ownership/use tests"). According to Sec. 121(b)(3) (A), the exclusion is allowed each time a taxpayer who sells or exchanges a principal residence meets the eligibility requirements, but generally no more often than once every two years. For a taxpayer who acquired his residence in a transaction covered by pre-TRA '97 Sec. 1034, new Sec. 121 (g) provides that the periods of ownership and use of the prior residence are taken into account in determining ownership and use of the current residence.

Example 1: S, who is single, sold her principal residence of 10 years on May 1, 1996 and deferred gain recognition under Sec. 1034. On the same day, S purchased and occupied a new residence, which she sold on Sept. 1, 1997. Under post-TRA '97 Sec. 121 (g), S's holding period in, and use of, her new residence is 11 years, four months. S qualifies for an exclusion of up to $ 250,000 of gain when she sells the new residence.

Reduced Exclusion

According to Sec. 121(c), if the ownership/use tests are not met for certain reasons, the exclusion is based on a ratio of the number of qualifying months to 24 months.(3) Specifically, under Sec. 121 (c) (2) (B), a taxpayer is entitled to a prorated exclusion if he fails to meet the ownership/use tests because of a change in place of employment, health or other unforeseen circumstances.(4) The prorated amount is the ratio of the aggregate amount of time the taxpayer actually owned and used the property as his principal residence during the five-year period (or, if shorter, the amount of time since the most recent prior sale to which the exclusion applied) to two years.(5)

Example 2: R, age 36 and single, purchases and occupies a principal residence in Jackson, Miss., on July 1, 1998. On Jan. 1, 1999, R is transferred by his employer to Houston, Tex. R sells his home on that date to his employer at a $ 75,000 gain. Because R is transferred due to unforeseen circumstances prior to the required two years, k can exclude $ 62,500 of gain (6 / 24 X $ 250,000) Thus, $ 12,500 of the gain will be taxable to R.

Example 3: The facts are the same as in Example 2, except that R is transferred overseas in January 1999 for five years, during which time the house is rented. When R returns, his employer transfers him to Fort Myers, Fla. If R sells his home in Jackson without reoccupying it, he is not eligible for an exclusion, as he did not live in it during the last five years. Under pre-TRA '97 law, R would have been able to defer the gain.

Under Sec. 121 (d) (2), the ownership/use tests are also met when an unmarried individual includes the period during which his deceased spouse owned and used the property before death.

Example 4: B and R were married in January 1996, and have since resided in B's residence of the past 10 years. B passed away on May 15, 1997; R sold the residence on Oct. 20, 1997. R passes the ownership/use tests; R does not individually meet these tests, but can include the 10 years during which B used the home as his principal residence.

Filing Status Issues

Under Sec. 121 (b) (2), the $ 500,000 exclusion applies to married couples filing jointly when either spouse meets the ownership requirement, both spouses meet the use requirement and neither spouse has had a sale in the preceding two years that was subject to the exclusion.

Example 5: T and V, both 35, married on Dec. 15,1997, at which time V joined T in his home of three years. In January 2000, they decide to sell the home and move into a new residence. If T and V file jointly, they can exclude up to $ 500,000 of gain on the sale. If they file separately, T can exclude up to $ 250,000 on the sale, because he meets the ownership/use tests.

A single taxpayer who marries a taxpayer who has used the exclusion within two years prior to the marriage would nevertheless be allowed a $ 250,000 exclusion.

Example 6: The facts are the same as in Example 5, except that V sold her home of five years in November 1997 and excluded the gain under post-TRA '97 Sec. 121 on the sale prior to moving into T's home; T's home is sold in January 1999. T and V can exclude up to $ 250,000 on the sale, because V previously elected to exclude gain under Sec. 121 within the previous two years.

Limiting the exclusion to one sale every two years does not prevent a husband and wife filing jointly from excluding up to $ 250,000 of gain from the sale or exchange of each spouse's principal residence, provided that each spouse would be permitted to exclude up to $ 250,000 of gain had the couple filed separate returns.

Example 7: The facts are the same as in Example 5, except that V sells her home of five years on March 3, 1998. T sells his home of three years on April 16,1998. In May 1998, V and T purchase a new home together. Each meets the ownership/use tests as to their former homes, so each is entitled to exclude up to $ 250,000 under post-TRA '97 Sec. 121 on the sale of the former residences on their 1998 joint return.

Once both spouses satisfy the eligibility requirements and two years have passed since the last exclusion was allowed to either, a full $ 500,000 exclusion is available for the next sale or exchange of their principal residence.

Transition Taxpayers

As mentioned previously, the TRA '97 creates a category of transition taxpayers who can choose between applying pre-TRA '97 Sec. 1034 or 121 or the post-TRA '97 Sec. 121 exclusion. In general, TRA '97 Section 312(d) provides that the exclusion is effective for sales of principal residences after May 6, 1997. A taxpayer may elect to be subject to the pre-TRA '97 rules if.

* The sale or exchange of the principal residence occurred prior to Aug. 5, 1997 (or after that date if pursuant to a binding contract in effect on Aug. 5, 1997) or

* The replacement residence was acquired before Aug. 5, 1997 (or pursuant to a binding contract in effect on Aug. 4,1997) and no gain on the sale would be recognized under pre-TRA '97 Sec. 1034.

This provision may be of particular interest to taxpayers who have gain on the sale of their principal residence in excess of the exclusion and are replacing their old home with a new one. Qualifying taxpayers

should consider taking advantage of the prior Sec. 1034 rollover provisions when the cost of the new residence exceeds the new allowable exclusion plus their basis in their old residence.

Example 8: F and A, both under age 55, are married filing jointly. They purchased their current home for $ 250,000, and have owned and occupied it for 25 years. They sold it for $ 2,000,000 on June 1, 1997. Under post-TRA '97 Sec. 121, they will recognize a gain of $ 1,250,000 ($ 2,000,000 -- $ 250,000 basis -- $ 500,000 exclusion). If F and A timely reinvest in a new residence costing $ 300,000, they would not choose to apply Sec. 1034 under the transition rules because the recognized gain would be $ 1,700,000. On the other hand, if the cost of the replacement residence is $ 1,100,000, they will recognize a $ 90(,(00 gain; an election to apply Sec. 1034 under the transition rules would be beneficial.

Taxpayers who owned a principal residence on Aug. 5, 1997 and sell the residence before Aug. 5, 1999, but who fail to meet the ownership/use tests can still qualify for a reduced exclusion.

Example 9: J and O, ages 29 and 26, respectively, married on May 24, 1997; they bought their first home on July 1, 1997. On July 1, 1998, they sell it at a gain. Because they owned the home on Aug. 5, 1997, they are entitled to exclude $ 250,000 (12 / 24 X $ 500,000) of gain.

Planning Opportunities

Taxpayers Age 55 and Over

Taxpayers age 55 and over who recently sold a principal residence and did not make a pre-TRA '97 Sec. 121 election may wish to consider amending their prior-year returns under Regs. Sec. 1.121-4(a) to make such election. This is particularly useful for taxpayers who opted to pay tax on any gain and reserve their pre-TRA '97 Sec. 121 exclusion for future use.

Consideration should also be given to taxpayers who may have invested in a replacement residence and deferred gain recognition under pre-TRA '97 Sec. 1034. Because gain deferred under that provision serves to reduce the taxpayer's basis in the replacement residence, amending a prior return now and making a pre-TRA '97 Sec. 121 election would effectively increase the taxpayer's basis in his replacement residence, potentially reducing future gain recognition. Thus, taxpayers electing to exclude gain under pre-TRA '97 Sec. 121 get a fresh start, with a new exclusion under post-TRA '97 Section 121.

Example 10: H and W, both age 58, sold their principal residence in 1995 for $ 200,000. Their basis in the home, purchased 30 years ago, was $ 125,000. If H and W recognized the $ 75,000 gain on their 1995 return, they may want to amend that return to elect gain exclusion under pre-TRA '97 Sec. 121, which will result in a refund. The gain excluded will not affect their basis in any replacement residence they may acquire. On the other hand, if H and W previously deferred the $ 75,000 gain under pre-TRA '97 Sec. 1034, they may want to amend their 1995 tax return to make a pre-TRA '97 Sec. 121 election and avoid the downward basis adjustment to their replacement residence that will carry over to post-TRA '97 years.

Change in Marital Status

The changes made by the TRA '97 recognize that taxpayers who marry, buy homes and subsequently divorce face many problems when dissolving their marriage, the least of which should be the tax ramifications on the sale of the personal residence. Thus, Sec. 121 (d)(3)(B), as amended, provides that divorced taxpayers who no longer reside in a principal residence may exclude up to $ 250,000 of gain, if the residence was the principal residence of either spouse at the time of a legal separation or divorce.

Example 11: D and T, ages 29 and 25, respectively, lived in a house owned by D until their divorce in 1996. Under the terms of the divorce agreement, T continued to live in the home until 1999, when it was sold for an $ 80,000 gain. D satisfies the ownership test and satisfies the use test through T's occupancy of the residence. Thus, D can exclude the gain under post-TRA'97 Sec. 121.

This provision is in stark contrast to the tax treatment of similar situations under pre-TRA '97 Sec. 1034. In Perry,(6) the taxpayer could not roll over his share of the gain from the sale of a residence he had lived in with his former wife, but in which he had not lived for almost four years before the sale.

The Perrys were divorced in late 1985; the ex-wife had the exclusive right, under the divorce settlement, to use the property until December 1987. At that time, the house was sold and the proceeds divided equally between the parties. The court found that Mr. Perry did not meet the use requirements under Sec. 1034 through his former wife's use of the property, denying him rollover treatment.

Taxpayers with Multiple Residences

Special consideration should be given to taxpayers with multiple residences; these homeowners should plan their occupancy of a particular residence to coincide with the ownership/use tests to avoid gain recognition.

Example 12: H and W, ages 52 and 49, respectively, are married filing jointly and own three residences: a family home in Indiana, a ski chalet in Colorado and a beach house in Florida. H and W ultimately plan to sell the family home and ski chalet and retire to the beach house. If they meet the ownership/use tests for the family home, they may sell it, exclude up to $ 500,000 of gain and move to the chalet. After meeting the ownership/use tests for that property, they may sell it, exclude the gain under post-TRA '97 Sec. 121, and retire to the beach house.

Loss of Indefinite Deferral

Homeowners with unrealized built-in gains exceeding the new exclusion face a tax on gain on the sale of their homes that previously could have been avoided under the rollover provisions. Thus, the new law may lock some taxpayers into the unenviable position of deciding whether to pay tax on gain exceeding the exclusion threshold on sale, or holding onto the home until death to possibly avoid gain. Taxpayers will no longer be able to indefinitely defer gains through a series of Sec. 1034 rollovers until the Sec. 1014 basis step-up at death.

Example 13: J and C, age 49 and 46, respectively, are married filing jointly. They have moved four times over the past 20 years, and each time deferred gain recognition under Sec. 1034. Although they paid $ 450,000 in 1993 for the house in which they have resided since 1996, their basis in the residence is only $ 75,000. If they sell their current residence in 2000 for $ 700,000, their gain is $ 625,000 ($ 700,000 - $ 75,000 basis), $ 500,000 of which may be excluded. If Sec. 1034 had not been repealed and J and C properly reinvested, they would have escaped gain recognition on the sale entirely. The only options available to J and C under post-TRA '97 Sec. 121 are to (1) sell and recognize a gain of $ 125,000 ($ 625,000 - $ 500,000) or (2) remain in the home until either spouse dies and possibly avoid gain recognition.(7)

Taxpayers should monitor the gain potentially taxable under post-TRA '97 Sec. 121 and be prepared to make decisions when it approaches the exclusion threshold. New strategies to avoid tax on the potentially taxable gain will likely emerge--e.g., a properly structured sale and leaseback may allow taxpayers to sell a personal residence, exclude any gain and continue to enjoy their home.

Reinvestment in a Cheaper Home

While the principal residence is the major asset of most middle-income taxpayers, many homeowners found little or no tax benefit under pre-TRA '97 Sec. 1034. Taxpayers who moved to a less expensive home, relocated to a less costly area, decided to rent instead of buy or had difficulty in finding a suitable replacement residence generally found Sec. 1034 problematic. Most were required to recognize all or part of the gain on sale. Post-TRA '97 Sec. 121 extends tax benefits to these middle-income taxpayers, because the gain exclusion does not depend on reinvesting the proceeds in a new home.

Recordkeeping

Form 2119, Sale of Your Home, was used to calculate any gain deferred under pre-TRA '97 Sec. 1034 and the basis of the replacement residence. Keeping Form 2119 and supporting records, in addition to records supporting any subsequent capital improvements, over long periods of time (often a lifetime) was necessary to properly compute and minimize gain recognition under Sec. 1034 on a later sale. The TRA '97 effectively ends such recordkeeping burdens for taxpayers who anticipate that gains on future sales will fall within maximum exclusion amounts.

However, there are still many excellent reasons to maintain good records. Recordkeeping is now more important for homeowners with sales in excess of the exclusion thresholds, because these taxpayers will be taxed on the excess gains. Taxpayers who sell their homes for an amount exceeding the exclusion threshold, but who realize no gain on such sale, should maintain adequate documentation of their basis in the residence sold. Future changes in marital status (due to death or divorce) may reduce the maximum exclusion amount from $ 500,000 to $ 250,000 for some taxpayers. Taxpayers claiming deductions for a home office or rental of a portion of the residence should continue to maintain records supporting such deductions. Also, to the extent post-TRA '97 Sec. 121 is modified or eliminated in the future, adequate records may facilitate favorable tax planning concerning the sale of a principal residence.

Depreciation

The TRA '97 resolves the conflict the Service has had with the Ninth Circuit's decision in Bolaris.(8) In Bolaris, the taxpayer vacated his residence and moved into a new house. While the taxpayer tried to sell his former residence, he intermittently rented it, deducting depreciation and other rental expenses; he eventually sold it. He successfully claimed Sec. 1034 nonrecognition for all of the sale gain, including that attributable to depreciation.

Under Sec. 121 (d)(6), as amended, taxpayers using their principal residence in part as a rental or business property will be required to recognize gain currently on the sale of the property to the extent of depreciation taken allocable to periods after May 6, 1997. This provision affects real estate investors and taxpayers who rent out a portion of their homes or claim home office deductions.

Gain Exceeds Exclusion

Certain taxpayers stand to be taxed on gains under post-TRA '97 Sec. 121 that would have been tax-deferred under pre-TRA '97 Sec. 1034, including those investing in areas of the US. with relatively high property values. Even a modest percentage increase in the appreciation of a home could produce a gain that is now subject to post-TRA '97 Sec. 121.

Example 14: L, single and age 40, invested in a principal residence in New York in 1983. L paid $ 600,000 for the home, which she recently sold for $ 950,000. If L reinvested appropriately, she would recognize no gain currently on the sale of the residence under pre-TRA '97 Sec. 1034. Under post-TRA '97 Sec. 121, however, L has a taxable gain of $ 100,000 ($ 950,000 - $ 600,000 - $ 250,000 exclusion).

Lower Capital Gains Rates

For taxpayers who will be required to recognize gain on the sale of a personal residence, the tax bill has been somewhat softened. Under TRA '97 Sec. 311 (a), the tax on most capital gains has dropped to a maximum of 20% for assets held longer than 18 months, and as low as 18% for homes held longer than five years (beginning in 2001).(9) Taxpayers depreciating all or a portion of their personal residence will pay a 25% rate on the part of the gain due to depreciation.

Conclusion

While the TRA '97 may not be a fundamental benefit to all taxpayers, the separation of the gain nonrecognition rule from the reinvestment requirement will offer more choices to taxpayers who sell a principal residence. The impact of these rules will allow older couples to exclude their gain and keep more of the funds for retirement and elder care needs. Thus, homeowners who sell their homes for retirement income, move into a smaller apartment or move in with a family member will benefit from these changes. In addition, most middle-class families changing jobs and moving to communities with lower housing costs will be able to exclude the entire gain and use the money saved by trading to a lower-priced home. Further, inner-city and rural communities with low housing costs could become more attractive to those wishing to purchase a home in those areas; sellers could keep some of the gain on sale of their current homes for other purposes. Finally, for a majority of Americans, these revisions will greatly reduce the recordkeeping requirements associated with keeping track of basis in a principal residence.

(1) Treasury Dep't News Release RR-1474 (2/1/97).

(2) See Pickett, Gardner and Streuling, "Maximizing Gain Exclusion/Deferral When Selling a Principal Residence Due to Death, Divorce or Marriage," 28 The Tax Adviser 90 (Feb. 1997).

(3) Sec. 121 (c) does not state how to compute the ratio. Until further guidance is issued, the use of either days or months would appear to be a reasonable basis for making the computation.

(4) Currently, "change in place of employment, health, or unforeseen circumstances" is not defined. Presumably, "change in place of employment" refers to an employment change meeting the time and distance requirements of Sec. 217.

(5) Under Sec. 121(d)(7), an individual who receives licensed care out-of-residence on account of physical or mental incapacity can include time spent in such residence as part of the two-year use requirement, if certain other rules are met.

(6) Curtis B. Perry, 91 F3d 82 (9th Cir. 1996) (78 AFTR2d 96-5797, 96-2 USTC [paragraph] 50,405), aff'g TC Memo 1994-247.

(7) Generally, the gain avoided at death is a function of applicable state law, including manner of ownership of the property and community property law versus common law considerations, the gain on subsequent sale and the allowable exclusion, as affected by filing status in the year of sale.

(8) Stephen Bolaris, 776 F2d 1428 (9th Cir. 1985)(56 AFTR2d 85-6472, 85-2 USTC [paragraph] 9822), aff'g, rev'g and rem'g 81 TC 840 (1983).

(9) The capital gains rates are discussed in Bukofsky and Sherr," Diverse Planning Opportunities Available Under the TRA '97 (Part I)," 29 The Tax Adviser 18 (Jan. 1998).

RELATED ARTICLE: EXECUTIVE SUMMARY

* The TRA '97 creates a category of transition taxpayers who can choose to apply (1) pre-TRA '97 Sec. 1034 or 121 or (2) post-TRA '97 Sec. 121.

* There are a number of exceptions to meeting the ownership/use tests.

* A $ 500,000 exclusion is available only if married filing jointly; it is $ 250,000 for all other taxpayers.

Nell Adkins, Ph.D., CPA Assistant Professor of Accounting College of Business Administration University of Houston Houston, Tex.

Gregory G. Geisler, Ph.D., CPA Assistant Professor of Accounting College of Business Administration Georgia State University Atlanta, Ga.

Steven C. Thompson, Ph.D., CPA Professor of Accounting College of Business Florida Gulf Coast University Fort Myers, Fla.

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HEADLINE: Incentive property taxation: a potential tool for urban growth management.

BYLINE: Gihring, Thomas A.

AUTHOR-ABSTRACT:

In their efforts to find more effective policies and mechanisms for urban; growth management, planners have yet to step off the regulatory plateau and; discover new approaches elsewhere. The subject of this study undertaken in; Vancouver, WA and Seattle is "incentive" property taxation linked to growth; management. Using county property assessment files, hypothetical tax; applications were performed on classes of land use. Simulating a heavy tax; on land values and light tax on improvement values demonstrated the shifting; of tax burden onto the land-extensive uses associated with urban sprawl,; such as parking lots, and the reduction of tax burden on land-intensive uses; such as apartments and office buildings. The study suggests that property; owners might respond to tax-based financial inducements to reduce the ratio; of land-to-improvements value by building more intensively on underutilized; sites. Prospects for infill development and the appropriation of speculative; gain are also examined.

BODY:

The urban land use planning profession, having received its legal basis historically from state enabling legislation and the local police power, has grown comfortable with the regulatory environment as a modus operandi. Rarely have planners looked beyond regulations for solutions to the twin problems of urban sprawl and central city stagnation. This study opens the case for a revised property tax system, by examining its power to influence land use allocation and its potential as a supplemental tool for managing urban development.

Recently, two vocal environmentalists have raised the issue of property taxes and their effects on the contemporary urban landscape. Both denounce the present system of property taxation as regressive. In his book Home From Nowhere (1996), James Kunstler targets the car-dominated American habitat as a failed experiment, asserting that "our system of property taxes may be the single most insidious, pathogenic factor contributing to the geography of nowhere" (Kunstler 1996). Alan Durning of Northwest Environmental Watch makes the argument in This Place on Earth that the nation's existing tax codes send the wrong message by penalizing work and investment, thereby accelerating urban decline (Durning 1996).

Adhering to a progressive liberal view of economic justice, proponents of the "green tax" movement maintain that value should accrue to the creator of value (Katzenberger 1992). The three factors of production commonly cited as combining to produce wealth are labor, capital, and land, where:

* wages are the return to labor,

* interest is the return to capital, and

* rent is the return to land, or to the steward of land, which is the public domain.

Unlike capital and labor, which are associated with productive enterprise, land refers to the gifts of nature. The mispricing or misuse of these free, fragile natural endowments, limited in quantity, leads to environmental degradation. According to Durning, "Taxes on [land] raise the price of using [it], which tells people to conserve. . . . Taxes on labor and capital tell businesses and households to scrimp on workers and tools - . . . to practice unemployment and underinvestment. A reasonable tax policy would tax the gifts of nature first and tax labor and capital only as a last resort" (Durning 1996, 227).

The alternative method proposed by Kunstler, Durning, and a growing number of environmentalists and converts to neotraditional planning rests on a foundation laid by a nineteenth century reformer. In his seminal book Progress and Poverty, the political economist Henry George laid out his fundamental premise for reform: the abolition of involuntary poverty by opening the earth's resources on equal terms to all. Wider access to land could be accomplished, he argued, by reducing taxes on wages and capital and raising taxes on land holdings. That would induce owners of unused sites to sell them at reasonable prices, thus bringing idle land into productive use and creating more employment (George 1880).

The basic principle recognized by land value taxation is this: land value accrues cumulatively, in a process generated by the community as a whole; as such, that value belongs to the community; it is only the building value that is created by private capital investment, and as such, belongs to the owner. Hence it is just for the public sector to appropriate land rent through taxation.

In its pure form-the abolition of all taxes save the tax on land-Henry George's theory was never actually applied. The idea of differential taxation, however, lived on and was incorporated into law in several British Commonwealth countries, Taiwan, Denmark, Holland, and two states in the United States. The city of Pittsburgh adopted land value taxation (LVT) during the municipal reform period of the 1920s, and several jurisdictions followed suit under Pennsylvania enabling legislation (Pickard 1962). In 1993, New York State adopted legislation allowing local use of the two-rate system. The stated aim was to stimulate development by increasing tax rates on land and reducing rates on buildings (Hennessy 1993).

Elements of Land Value

In contrast to the conventional, equal-rate system that applies the same tax rate to land and to improvements, a revised two-rate property tax structure taxes the assessed land value of each parcel at a higher rate than that on the building assessment. The two-rate system's rationale is exemplified particularly clearly in urban areas where land value is largely site value, that is, the market value generated by the presence of public infrastructure, nearby public and commercial facilities, natural amenities, and accessibility (Mills 1969). Thus, in principle, this heavier tax on land taxes mainly the land rent (or economic rent) created over time by the community at large, not the capital invested in the property improvements.

A second point here is the effect of the taxation system on owners' decisions about improving property. In practical terms, for individual owners the market value of land is the speculative value of the given sites. We have noted that as land values rise, the increases can be preempted by owners through higher resale prices, or they can be captured (at least in part) by the public sector in the form of tax revenue. If an owner undertakes no capital improvements on a property, the future resale profit from that landholding is a purely speculative gain, or windfall; if the owner does add improvements, they also add to the amenity of the area, and thus create an increment of community wealth. But under the present equal-rate system of taxation, the owner has no tax-based incentive to invest in property improvements, because doing so will result in higher taxes. Thus, inherent in the equal-rate method of property taxation is a built-in disincentive to invest in substantial capital improvements.

Benefits of Land Value Taxation

Land use decisions by individual property owners could be affected by taxation if the financial incentives or disincentives were sufficiently strong in proportion to the full economic rent. That is, if the additional tax burden imposed on land by converting from an equal-rate tax to a land-based tax were to approach the speculative gain derived from land value inflation, an owner may decide to convert to a more building-intensive use or to sell the land to a buyer willing to undertake a substantial capital investment. Proponents of two-rate incentive taxation anticipate several significant benefits to the public interest (Gaffney 1993). They are elaborated below.

1. Placing proportionately higher taxes on land would make it more costly to hold on to vacant or underutilized, centrally located sites. Trends toward infill development and a gradual recentralization of urban development would emerge. The demand for peripheral sites at the urban fringe would correspondingly diminish.

2. Reducing the tax burden on improvements would facilitate revitalization and the replacement of obsolete buildings in older central cities. Property owners, responding to the financial inducement to reduce the land-to-building value ratio, would build more intensively on vacant and underutilized sites. The cumulative effect over time and space would be to increase property values, and thus the tax base, where that is most needed.

3. The two-rate tax would discourage land speculation, that is, the holding of unimproved or under-improved property for the purpose of reselling profitably without any substantial capital investment. A differential tax rate that was high compared to land price inflation could diminish the accumulating windfall for the holdout owner. That is, if the tax would capture a large portion of the land's economic rent, the owner would in all likelihood capitalize the depletion into a lower resale price.

Urban Growth Management

The previous discussion makes apparent the close relationship between the expected benefits of land value taxation and the commonly stated objectives of urban growth management (UGM). In general, UGM seeks to promote a suitable relationship between land use and infrastructure, that is, more efficient use of land in order to conserve land rather than consume it (Gallion & Eisner 1980). Land use efficiency can be achieved through compact urban form, establishing ordered relationships among the places devoted to utilitarian functions such as work, shopping, recreation, and socializing, and at the same time maximizing their compatibility (by defining zoning districts), maximizing accessibility (by designing a balanced transportation system and reducing distances between origins and destinations), and minimizing energy consumption.

Although the rationale for land value taxation is independent of UGM, the overlap of purpose is clearly discernible. In essence, the double-sided coin of incentive property taxation has these two principal objectives (Rybeck 1992):

1. Tax away the speculative value of property, by rewarding capital investment.

2. Bring idle land into production, by penalizing speculative land holding.

A two-rate system's expected outcomes can be summarized as follows:

* Discourage urban sprawl

* Encourage infill development

* Discourage building disinvestment

* Intensify land development

* Discourage land speculation

* Restrain rising residential land prices

The overlap between incentive property taxation and UGM can be seen in the legislation adopted by the state of Washington in 1990. Emulating a model established by several precedent-setting states such as Oregon, California, and Florida, the Washington State legislature in 1990 adopted the landmark Growth Management Act (GMA), a comprehensive set of goals, strategies, and enforcement provisions to guide land development (Washington State Growth Strategies Commission 1990). The state's growth management objectives can be summarized as follows:

* Preserve rural open space and resource lands

* Prevent sprawling, low-density development

* Direct new growth to existing centers

* Encourage infill and contiguous development

* Encourage redevelopment in economically depressed sub-areas

* Revitalize declining central business districts

* Use public infrastructure more efficiently

* Reduce automobile dependency; support transit and pedestrian modes

Applying Incentive Taxation

To date, only limited attempts have been made to use the public's power of taxation to achieve growth management objectives. Both Washington and Oregon have adopted the practice of assessing farmlands, open space, and forestlands at current use value rather than full market value (that is, exchange value). The intent is to encourage farmers and foresters, through lower taxes, to continue natural resource-based economic activity and to resist the temptation to sell lands located in the urban fringe for development (Washington State Dept. of Revenue 1993).

Negative applications of incentive property taxation also are legally available but, again, in only limited use. The state of Vermont uses a Land Gains Tax to protect rural land from short-term speculation. A high capital gains tax on resale within a one- or two-year period targets owners whose intent in buying up resource lands was to profit from their conversion to urban use, and allows local jurisdictions to capture up to 80% of such windfall profits (Daniels, Daniels, and Lapping 1986).

Even less used are tax mechanisms that incorporate both rewards and restraints concurrently. Planners and lawmakers could profit by examining more carefully how incentive taxation could be used to simultaneously encourage wise land use practices and discourage land speculation and sprawling development.

The Two-Rate Taxation Method

Under the conventional, equal-rate property tax system, each owner's tax bill is prepared by multiplying the total assessed value (TV) by the levy rate, usually expressed as a per-thousand-dollar figure, or mill rate. For example, if the assessed value of a given property were $ 100,000, and the levy rate were $ 13 per thousand of assessed value, the tax bill would be $ 1,300. In each county the assessor calculates the levy rate by dividing the

total projected revenues authorized for the various taxing districts by the total assessed value of real estate in the county. To find the mill rate, the resulting ratio is multiplied by 1,000.

Under the alternative two-rate property tax system, the total levy rate is split, and applied differentially to land values (LVs) and to improvement values (IVs). The assessed land value of each property is multiplied by the higher fraction of the levy rate, and the assessed building value is multiplied by the lower fraction. In this study, the proportionate rates for land and buildings are derived from a land value tax (LVT) level denoting the percentage of the levy rate that the taxing authority chooses to apply to the land value.

The two methods of taxation are illustrated in the following example of a $ 13 levy rate applied to a $ 100,000 property:

Conventional Application:

LV: $ 40,000

IV: $ 60,000

TV: $ 100,000 $ 100,000 / 1,000 x 13 = $ 1,300

Two-Rate Application:

(Using an LVT level of 75%, the total levy rate of $ 28.85 is the rate required, when multiplied by the land and improvement ratios, to produce separate mill rates that will yield the revenue-neutral tax of $ 1,300.)

LV: $ 40,000 $ 28.85 x .75 = $ 21.65 $ 40,000 / 1,000 x 21.65 = $ 866 IV: $ 60,000 $ 28.85 x .25 = $ 7.25 $ 60,000/1,000 x 7.25 = $ 434

TV: $ 100,000 $ 1,300

Note that, in practice, the concept of revenue neutrality applies not to single parcels but to an entire taxing jurisdiction. Thus, individual properties' tax bills may be either higher or lower as compared to the conventional tax, though all are taxed under the same set of differential rates.

There is general agreement among the advocates of land value taxation that a two-rate system should be introduced gradually so as to minimize the effects of any abrupt change in tax billing for the owners most affected by the differential tax. A phase-in period gives the property owners whose taxes rise an opportunity to gradually adjust property prices downwards, as the capitalized market value of their land diminishes because of the land value tax (Congressional Research Service 1971). The phase-in also gives owners time to adjust their investment decisions. For example, the anticipation of increasingly higher land tax burdens may prompt the earlier sale of underutilized property, or investment in building improvements. A transition period-maybe ten years, more or less-during which the levy rate differential gradually would rise to a concluding level, perhaps short of a 100 percent land value tax, would avoid undue financial stress on land owners. Figure 1 contains the derived mill rates for a revenue-neutral tax application during a simulated phase-in period when the land tax rate is raised incrementally. The initial rate for the Vancouver area is the current conventional rate of $ 13.93 per thousand assessed valuation.

What is an appropriate concluding LVT level is subject to a variety of opinions. One would hope the rate differential would be enough to appropriate a substantial portion of the land rent within a taxing jurisdiction. In urban areas where growth pressures are strong, high land value inflation would be expected. Consequently, higher LVT levels might be needed in those areas to recapture the annual gains in land value. Where the real estate market is soft, however, too high an LVT level could trigger a shock wave that depresses property values

excessively. In terms of the public interest, one could also aim for incentive effects that generate property upgrading and infill development activity.

There is no logical reason not to consider a full tax on land values (excluding an improvements tax). However, the choice was made in this study to advance a method which has some precedent in the United States, namely the Pennsylvania "two-tier" system. In any case, the amount of land rent captured by a full LVT would differ only minimally from that recovered by the 95% LVT utilized in this study.

A series of hypothetical two-rate tax calculations are run on aggregations of assessed value representing classes of land uses. The series of applications consists of six progressively higher LVT levels, illustrated in figure 1. The derived tax rates, adjusted for revenue neutrality, yield the same total revenue as the conventional rate applied to all properties in the Vancouver urban growth area of Clark County, Washington.

Figure 2 illustrates the application of a graduated two-rate tax rate to the land and improvement assessments on a typical single family residential parcel valued at $ 173,725; during the phase-in period, the tax on improvements gradually decreases and the tax on land assumes greater proportions. In this particular case, the total tax bill decreases over the phase-in period. In the aggregate, the tax burden would be reduced for some properties but increased for others; the total revenue collected would remain the same.

The Vancouver-Clark County Setting

This study is designed to simulate the fiscal effects of a two-rate tax on properties in the 80-square-mile Vancouver, Washington urban growth area (UGA). This setting offers an opportunity to examine the possibilities of using the incentive power of land taxation in concert with the state's GMA regulations to bring about a more effective means of managing urban growth. Although the conclusions are preliminary, the study attempts to test the hypothesis that both LVT and GMA objectives can be achieved by changing the conventional taxation system to a two-rate land value tax system.

Clark County is the fastest growing county both in the Portland metropolitan area and in Washington State. [ILLUSTRATION FOR FIGURE 3 OMITTED.] Population increased 21 percent from 1990-1995, to over 290,000, and is expected to grow by 134,000 persons over the next 20 years. In 1980 about 22,000 Clark County residents were crossing the Columbia River to work sites in Oregon; by 1990 the number had increased to nearly 37,000. This amounts to a third of the county's work force (Nokes 1995).

The county's role as a bedroom community is reinforced by the tax disparity between Oregon, which has a personal income tax, and Washington, which does not. Oregon also has no sales tax, whereas Washington (Clark County) imposes a tax of 7.6% on nonfood goods and services. Consequently, many Clark County residents work and shop on the Oregon side of the Columbia River though they sleep on the Washington side. The long-term result is that Vancouver's central business district (CBD, located on the edge of the state boundary) has languished. Measured in total assessed value, downtown properties classified as general merchandise retailing account for only 1.4% of the UGA total. A markedly high parcel count in the land use class for parking-over three-quarters of the Vancouver UGA total--suggests that a significant amount of centrally located land area is given over to automobile-related uses.

Much of the current construction boom is in the eastern sector of Vancouver, near the urban growth boundary adjacent to the town of Camas, where new manufacturing plants have located. Recently, a Taiwan-based semiconductor corporation named the Cascade Business Park as its choice for a $ 1.2 billion manufacturing plant that will employ 800 workers by the end of the decade, and is planned to expand to an eventual work force of 7,000 (Paulson 1996). Comparable expansion activity is anticipated in the area seven

miles north of downtown Vancouver, where a new 348-acre branch campus of Washington State University has recently opened.

Urban Sprawl

Concurrently with rapid population and employment growth, raw land is being developed to accommodate housing, industry, and commerce. Land conversions near the urban fringe seem to occur despite the availability of buildable sites within existing urbanized areas. Clark County files of subdivision and building permits show that a land rush of sorts occurred in anticipation of the Vancouver urban growth boundary designation in 1994 and its attendant rezoning. Developers and resident owners expanded urban development into semirural areas, appropriating buildable sites on scenic hillsides and riparian lands.

The corollary of rapid population growth and a high rate of land consumption is low-density urban sprawl, which manifests itself in two ways: (1) leapfrog development and (2) low-density development or extensive land utilization. The antithesis of these sprawl conditions can be found in the GMA objectives listed earlier: (1) centralization (centripetal not centrifugal forces guiding the path of development), as well as contiguous development patterns; and (2) compact, higher-density, or intensive land utilization.

By documenting the location and quantity of both vacant and developed sites, it is possible to measure the extent of urban sprawl.(1) A leapfrog pattern of development is evidenced by the large number of vacant sites found in the inner suburban ring, and lower proportions of vacant sites in some outlying areas. Under a hypothetical "no sprawl" pattern wherein overall vacant site ratios do not exceed that of older sections of the city, the lateral extent of urbanization would be constricted to an area only 63 percent of the current urbanized area. The pattern of scattered, low-density development is firmly imbedded in the regional landscape.

Associating Land Utilization with Land Value Assessment

With reference to the problems of urban sprawl and the GMA objectives that counteract them, the following research questions arise:

* How might a land value tax affect owners' decisions about land utilization?

* Would shifting the property tax burden onto vacant and underutilized sites create enough financial incentive to stimulate more contiguous development of land within the urban growth boundary?

* Would tax burdens on downtown vacant and underutilized sites induce centralization and revitalization?

* Would a lower tax on improvements facilitate the eventual replacement of low-intensity uses with more building-intensive uses, as envisioned by the Clark County Comprehensive Plan?

To know whether property taxation has any effect on land use, it is necessary to establish an operational relationship between the two concepts. From the planners' perspective, the key to efficient land use is compact urban form, which is a function of development intensity, and can be measured at its most elemental level as building area coverage. But intensity is a physical phenomenon, not a fiscal measurement. If there is found to be a positive correlation between building intensity and the monetary value of improvements relative to land, then the intensity at which land is used would be reflected in property assessments, the basis for determining tax burden.

Building intensity as a physical measurement of site utilization is expressed as a ratio. Dividing a building's internal square footage by the lot's square footage yields a floor area ratio (FAR). Put in valuation terms, building intensity is the building value to land value ratio (BLR). Table 1 contains the aggregated figures from which the site ratios and value ratios are derived.(2) If value ratios correlate with site ratios, then one can expect

land value taxation to affect properties according to their intensity of use. That is, on a given parcel the tax burden shift accompanying a change from the conventional to the two-rate system would coincide with the intensity of use. Properties having substantial improvements relative to the land area could anticipate lower taxes, while vacant sites and properties using extensive land areas and with only marginal improvements could expect higher taxes.

Although the number of land use categories is small, it can be seen that building-to-land valuation ratios (BLRs) do generally compare with building-to-lot area ratios (FARs), especially when the three single-family housing types are collapsed into a single category. On average, FARs are about 6% of the BLRs (or 56% if a factor of 10 is used for a clearer graphic illustration). This association is illustrated in figure 4, where the right-hand column represents the overall average.

The notable exception to this norm occurs within the single-family class of properties. Small, single-family lots are found to use about 29 percent of the lot area as building floor space, but large-lot parcels use only about 6 percent of the lot area as building space. Nonetheless, the valuation ratios for these two categories are not very different. Mean lot sizes in the large-lot category are six and a half times the mean size of small-lot parcels, yet their current assessed land value is less than double the mean value of small-lot parcels. Even within geographic sub-areas (-square-mile sections) where unit site values are expected to be comparable, larger single-family developed lots are consistently valued lower on a square footage basis.

The implication is that the land components of large-lot, single-family land parcels are assessed at a level below what their site use would indicate.(3) Therefore, as current assessments now stand, two-rate results for this particular category will not be consistent with the intensity of land use. The results of this test of association are that, generally, there is a relationship between building intensity and the valuation ratio, which itself determines the degree of tax burden shift. With the exception of large-lot residences, of which there are many, the tax burden for land-extensive uses can generally be expected to rise under the two-rate system.

The L-TV Ratio

The key variable in two-rate taxation methodology is the ratio of land value to improvement value. This study, however, adopts the expression of land-to-total value (LTV) as the preferred measure. This measure, the proportion of assessed value attributed to land, determines the degree of the tax burden shift caused by the transition from the conventional tax to a two-rate application. The [TABULAR DATA FOR TABLE 1 OMITTED] measure can be applied to single parcels or to aggregations of parcels. For the Vancouver UGA, the overall ratio of .31 is derived by dividing the summation of assessed land value - $ 2.7 billion - by the summation of total assessed value - $ 8.8 billion. In terms of the building-to-total value ratio, which is the reciprocal of the L-TV, the average property contains a building valued at 69 percent of the total assessment.

Under the conventional tax system, the value of site improvements as a proportion of the total property value would make no difference in the tax outcome. Under the two-rate system, the county-wide L-TV ratio determines the breakpoint at which tax burden shift occurs. With land taxed at a higher rate, any property having an L-TV higher than 0.31 would be taxed more than it would be under the equal rate system; any property with land comprising less than 31 percent of the total valuation would be taxed less.

The shift in tax burden under the change from the conventional to a two-rate application is expressed as a percentage, or rate of change in the tax amount, using the conventional tax amount as the base figure. This is illustrated in figure 2, where the difference between the column height of the conventional tax amount and the column height of any selected LVT application represents tax burden shift. Simulated two-rate property tax

applications were performed at all five levels of land value taxation, beginning at a 55 percent tax on land and concluding at a 95 percent tax on land. The local tax rates used are those shown in figure 1.

Tax Impacts on Land Use Classes

The overwhelming numbers of single-family residential properties drive the outcome of the two-rate tax application. This land use category consists of over 53,000 parcels, or 80 percent of the total properties in the Vancouver UGA. It accounts for 68 percent of the total assessed value and tax revenue collected within the UGA. (See table 2.) Because of differences in lot size and value, as well as in building size, value, and condition, the land-to-total-value (L-TV) ratio varies within this class of properties; the overall ratio is 0.30. This category's L-TV ratio, which is lower than the overall ratio of .31, is the first indication that single-family residences, as a group, can expect a slightly reduced tax burden under a two-rate application, thereby shifting the burden onto other uses.

Table 3 compares the results of a conventional tax application to the 95 percent LVT, for seven major land use categories. At this highest LVT level, single-family residential properties have a 4.5 percent decrease in tax burden. Multifamily housing types receive the most significant tax break under the two-rate system-a 34 percent reduction. Vacant or unused sites receive the largest tax increases, beginning at 12 percent under the initial [TABULAR DATA FOR TABLE 2 OMITTED] 55 percent LVT level, and concluding with a 162 percent increase. Under the conventional system, vacant parcels, which comprise about 11 percent of all Vancouver UGA parcels, contribute only about 5 percent of the total revenue. Under the two-rate system their revenue share rises to 12.4 percent, offsetting the downward revenue shifts in all developed residential parcels combined. As might be expected, commercial uses vary widely in the intensity of land use. In the Vancouver UGA, retail sites appear to be used less intensively than industrial/manufacturing sites. Indeed, a cursory field inspection reveals that strip or auto-related retail configurations predominate in both city and suburban locations. Overall, the upward tax burden shift onto subcategories within the retail/food service land use type ranges from 2 percent to 26 percent, resulting in an average per-property tax increase of about $ 2,000 under the 95 percent LVT hypothesis.

Thus far, the analysis of tax shifts supports the general premise that the consequences of a two-rate tax system are related to the intensity of land utilization. But when the single-family use category is broken out by parcel size, differences appear. Tax application results (not shown) reveal that under a two-rate hypothesis, taxes are reduced for all sub-classes except large-lot, single-family properties (exceeding 12,000 square feet), where the mean tax increase is a modest $ 211. If land assessments reflected lot size, the tax shift would be considerably higher. Also noteworthy is a greater downward tax shift for medium-lot parcels (-13.2 percent) as compared to small-lot parcels (-5.6 percent).

[TABULAR DATA FOR TABLE 3 OMITTED]

Tax Impacts on Underutilized Sites

Two primary purposes of land value taxation have been identified: taxing away the speculative value of property, and bringing idle land into production. The demonstration here that the general effect of LVT is to tax vacant parcels and land-extensive uses more heavily, raises two questions:

* Does this tax shift create enough incentive to discourage land speculation, that is, to encourage either sales of land holdings or more intensive site development?

* Would the tax encourage infill development or a more contiguous development pattern?

Land Speculation

To realize the first aim - discouraging land speculation - tax revenues must capture a substantial portion of the economic rent on these sites. One way of looking at this possibility is to capitalize the two-rate tax liability over a holding period and compare it to the land value residual. If the appreciation on land plus whatever net income or worth is derived from the site with property taxes paid is less than the return on an alternative investment, then the owner's investment decision may be to sell sooner or convert to a more land-intensive use. Table 3 shows that under a 95 percent land value tax, the tax burden shift on vacant sites from the two-rate system amounts to an increase of 162 percent over the tax under the conventional system. For the average site, this is an increase from $ 822 to $ 2,154. The question is whether this higher tax liability offsets the annual appreciation in land value.

An alternative approach to the problem is to simply compare the annual tax liability with the annual increase in land value on sample properties. Property sales records reveal the extent to which land values have been rising in Clark County (Clark County Department of Community Services 1996). During the period 1990-1995, average site sales prices rose from $ 39,500 to $ 80,300, resulting in a remarkably high average annual rate of increase, 15.2 percent. The following analysis assumes that an owner of a vacant parcel can appropriate this amount of gain each year the property is held. This gain of course is potential; it would be realized only if the site were sold at market value. To differentiate "speculative" gain from simple appreciation in value, the general monetary inflation rate, estimated to be 3.7 percent per year, is subtracted from the total increase in land value over the period of the calculation, eleven years. Tables 4 and 5, and figures 5 and 6 represent "recapture scenarios" for a typical five-acre, exurban vacant site near the eastern fringe of the Vancouver UGA.

Table 4 compares biannual land value increases and speculative gains with biannual tax liabilities over a phase-in period of eleven years. The second line shows how the land value of the subject parcel increases at the second year of each two-year period, and the third line shows the annual net increase (11.5 percent) in speculative gain at those years. Both conventional and two-rate taxes, reported in constant dollars, are shown for the projected land values at these years.

It is evident that under the trend growth rate scenario, the conventional tax can recover only a fraction of the annual speculative gain in value. The tax on land, valued in the third year at approximately $ 423,000, amounts to about $ 5,900, in comparison to the annual speculative gain of about $ 41,000 - a recapture rate of 14 percent. The next lines of the table show the effects of a phased-in, differential rate tax. At year three, a 55 percent LVT recovers 16 percent of the speculative gain, marginally [TABULAR DATA FOR TABLE 4 OMITTED] more than the conventional tax does. By the eleventh year, a 95 percent LVT captures as much as $ 18,300, but by this time the annual speculative gain in land value is over $ 97,000. Nevertheless, the two-rate tax captures 53 percent of the projected gain, in contrast to only 19 percent captured under the conventional tax that year. Note (Figure 5 represents these results in graphic form) that the recapture rates on a typical vacant parcel in the city center are almost identical.

Common sense would probably conclude that the high rate of growth in land values in Clark County during the past several years cannot last. If general inflation in the regional economy remains just under 4 percent annually, a 15 percent growth in land prices is too great a difference to be sustained. After ten years the vacant exurban site now worth $ 319,000 would be valued at $ 1.3 million under a trend growth rate scenario. But on the other hand, if the growth rate in Clark County property values were to decline gradually, would the land value tax then be able to capture the better portion of the speculative gain?

Table 5 presents a reduced growth rate scenario, using the same subject property, in which annual growth rates in land value decline steadily from 15.2 percent in the base year to 8 percent in year 15, as shown on the first line. As in the trend scenario, the two-rate tax is graduated. Results show that as land price inflation decreases, the amount of speculative gain captured by the differential tax increases significantly, as depicted graphically in figure 6. By the tenth year of the reduced growth rate scenario, the two-rate tax captures over 90 percent of the gain, and probably influences land allocation decisions.

If, according to reason, a high growth in land values is not sustainable, the application of a land tax would itself account for part of a reduced rate. Over time, land market values throughout the sub-regional market would show the dampening effect of increasingly high two-rate tax burdens on vacant sites, capitalized into lower resale prices.

The evidence of the reduced growth rate scenario supports the conclusion that an incentive tax policy that dampens high growth rates in land prices may also restrain land speculation by capturing a larger portion of the speculative gain. It is also evident that the conventional tax falls far short of capturing this unearned increment and affecting either land prices or land allocation decisions towards favoring capital investment.

Contiguous Development

From the point of view of growth management, one goal of land value taxation might be to have owners' tax burden shifts prompt their decisions to intensify development within urban centers, thus deflecting the pressure on land conversion at the urban fringe. However, this result would be conceivable only if land values and tax burdens were low in the fringe areas and high in the urban centers. Within the Vancouver UGA, a considerable unevenness is found in the land price topography. Measured in unit (per square foot) figures, the assessed market values of residential sites range from over four dollars to less than one dollar on sites near the urban [TABULAR DATA FOR TABLE 5 OMITTED] growth boundary. However, unit prices drop rather quickly outside the downtown area. Immediately northeast of the CBD, mean land values are less than two dollars per square foot; some land values in more outward areas rise to well over that figure.

A more detailed examination of tax effects in geographic sub-areas is accomplished by identifying mile-square survey grid sections that delineate three urban growth corridors extending north, northeast, and east from the CBD. The results of a simulated two-rate tax application on properties within these sectors show no linear relationship between distance from city center and tax burden shift, among either vacant or developed parcels. The LVT is not differentiated geographically between centrally located sites and distant sites. Centralization as a key objective of urban growth management cannot be achieved, under these circumstances, through the application of LVT to individual parcels.

Infill Development

Ideally, under the two-rate system tax burdens would be highest in urban centers, where the presence of substantial building improvements could be expected to result in large tax reductions, and where vacant and underutilized sites would have heavy tax increases, thus providing financial incentives to bring about infill development and general upgrading. The LVT data for Pittsburgh and other cities where development effects have been documented tend to support the notion that the real power of incentive taxation is to stimulate central city revitalization (Oates and Schwab 1992).

The central business district of Seattle is chosen as a subject for this analysis because of the evidence of recent speculative activity in the midst of renewed investments in building improvements. King County assessment records reveal that land values have been rising. Countywide land values during the period

1985-1995 are calculated to have risen, on average, 8.9 percent annually. For purposes of illustration, it is assumed that long-term owners of downtown sites are in a position to realize the total value of this rate of increase for each year that their properties have been held. The analysis views a portfolio of twenty-eight parcels owned by the Samis Land Co., which recently were entrusted to new management for the purpose of improving their value and use. Historically, the disincentives inherent in the conventional property tax system have offered little redevelopment inducement to Samis, which ". . . owned more property in downtown Seattle - and had done less with it - than any other private landowner in the city" (Keene 1996, A1). Might an alternative two-rate tax have induced the owners to redevelop these properties sooner, rather than to hold the land for speculation and dampen the general climate for reinvestment?

The method of illustrating the hypothesized tax effects is similar to that in the Clark County example. It is assumed that the taxing jurisdiction phases in the two-rate tax in two-year increments, raising the LVT level initially by 5 percent, and then by 10 percent at each biennial reassessment period. The Seattle school district's 1995 conventional mill rate of $ 10.95 is used to derive the differential rates for a revenue-neutral tax application. The rate at which improvement values rise is assumed to decrease, reflecting building depreciation levels prevalent in King County. According to these assumptions, projected land values would increase from the base year by a compounded rate of 8.9 percent annually. From this growth rate is subtracted a long-term general monetary inflation rate of 4 percent, for an annual rate of speculative gain of 4.9 percent. The recapture scenario, summarized in table 6 and illustrated in figure 7, uses two Samis properties and one comparison building.

The Douglas Hotel. Like six other buildings in the Samis portfolio, the Douglas Hotel had been in deteriorated condition, so its improvements are assessed at a nominal $ 1,000. By Year 3, when the lowest gradation of the two-rate tax is in effect, the conventional tax captures only 25 percent of the annual speculative gain, while the [TABULAR DATA FOR TABLE 6 OMITTED] differential tax captures a slightly higher percentage. By Year 11, when the highest LVT ratio is in effect, the conventional tax captures a third of the speculative gain, but the differential tax recovers more than three-quarters of the annual gain.

The Schwabacher Building. This building is more typical of the Samis holdings. Improvements are valued at $ 295,700, yielding an LTV ratio of .63, considerably higher than the overall county ratio of .43. The recapture rates of the conventional tax are higher than those for the first building, simply because improvements comprise a greater proportion of the total value. However, the two-rate tax recapture rate rises more rapidly, appropriating 26 percent more of the speculative gain by the time a 95 percent LVT is phased in.

The Third Avenue Office Building. Because the improvement value ($ 137,240,000) contributes substantially to the total property value of the Third Avenue Office Building, conventional taxes on this premium comparison property are high in the base year and increase during the eleven-year period as land and building values appreciate. In fact, in every subsequent year the tax bill far exceeds the total annual speculative gain on land value, thereby appropriating a large share of the owner's return on capital investment. This illustrates the built-in disincentive of the equal-rate tax system. In contrast, the two-rate tax during the phase-in period quickly compensates for the disincentive by lowering the tax ratio on improvements, from the point at which 164 percent of the gain in value is captured to a recapture rate of 97 percent. Tax liability gradually diminishes during the phase-in period, yielding an annual savings to the owner of almost $ 2 million by the eleventh year. Thus, capital investment in building improvements is rewarded through the incentive of lower taxes.

Within the parameters of this study it is impracticable to predict the type of investment decisions that Samis Co. or other property speculators might have made under the taxing systems compared here. To do so would

require calculating land value residuals on each property by devising hypothetical proformas to incorporate holding expenses, net operating income, and such capitalized costs as demolition or rehabilitation that buyers might want to negotiate. Nevertheless, the incentives simulated in this scenario do point in a positive direction. The two-rate system appears to substantially penalize the practice of disinvestment, and to reward efforts to improve downtown commercial properties.

Unit land values in the Seattle area are over twelve times those in Vancouver, so in absolute dollar amounts the tax burden effects are substantial. Tax recapture rates are higher in Seattle not because of the higher land costs, but because inflation rates for land values are lower. Because recapture rates are negatively associated with the rate of land value inflation, the policy objective of LVT should be to bring down land price inflation by taxing properties at levels as close to the speculative value of land as possible (full land rent), regardless of the dollar amounts and regardless of their location. In the Vancouver UGA, land values are not much lower in exurban areas than in some central city and suburban areas. This is because the speculative value rather than the use value prevails. Speculative land values often drive developers further out into the urban fringes, thus advancing urban sprawl and exerting upward pressure on land prices, in successive waves.

Evaluation of Two-Rate Taxation

Following the mandate of the Washington State Growth Management Act (GMA), Clark and King county planners are endeavoring through the regulatory mechanisms of zoning and urban growth boundaries to impede the rapid advance of urban sprawl. This study's analysis strongly suggests that their efforts could be reinforced if legislators and other governmental departments would join in revising the property tax system to offer built-in financial incentives.

Growth Management

The results of the analyses of differential property tax applications show that the alternative tax system does have the potential to produce some of the effects associated with growth management objectives. Under present circumstances, however, there are limitations to that potential.

Centralization. First, centralization as a GMA objective cannot be achieved through LVT alone. Unless subregional land value gradients are sufficiently steep, peaking at a central core, the land-based tax system cannot exert a centripetal force on development. Through uncoordinated economic development policies that allow new major growth attractors to be sited in predominantly undeveloped locations, Clark County appears to be, by default, developing around multiple nodes while ignoring established centers. This only increases land speculation, pushing up land values in outlying areas.

Intensification. For the GMA objective of development intensification, the alternative tax system holds considerable promise. The fiscal incentives observed here are consistent, for the most part, with the desired outcomes of rewarding land-intensive uses. However, when land value assessments are not commensurate with lot size, the power of the two-rate tax to induce infill and more intensive development is limited. On sites with low-intensity uses, excessively low land assessments can produce the anomaly of tax reductions rather than tax increases.

Anti-speculation. As for the anti-speculation objective of land value taxation, LVT offers much better prospects for capturing land rent and dampening land market prices than does the conventional system. LVT's potential for immediate results in the rapidly growing area of Vancouver is limited only by the current high rate of land value inflation. However, the application of the two-rate tax would itself help to dampen land price

inflation. Being broad-based, the LVT would be likely to arrest the current high rate of land price inflation in the sub-region, as the added tax liability on land-extensive uses was capitalized into lower selling prices.

Infill development. As for infill development, LVT could precipitate capital investment in buildings, if not in response to the negative incentives, then for the prospect of lower taxes on improved properties. Yet, in instances where land value inflation is high, even a 100 percent land tax would not (in a static model) recapture amounts approaching the annual gain in speculative value on underutilized sites. In such circumstances it might appear that only the "pure" Georgist principle of taxing full economic rent (by raising overall tax rates) would achieve the goal of influencing owner investment behaviors and dampening land value inflation. However, even under the less radical two-rate structure, land value inflation would gradually decrease as an effect of higher taxes on land. Eventually, lower land values would necessitate upward adjustments in the tax rate in order to achieve revenue neutrality.

Other Considerations

Only time and experience will tell whether financial incentives as a management tool could eliminate the need for some GMA regulations. It does seem apparent that certain legal mechanisms would be needed to prevent premature land conversion in outlying locations. The dilemma of using incentive taxation for fringeland sites and is that the greater the margin between use value and market value, the greater is the impact of the tax. Because a high tax on resource lands and open space reserves works against their preservation, a means of reducing market values to use value levels is needed. In this case, effective zoning to preclude urban uses in holding zones may be the only way to dampen speculation by constraining the rise in market values.

In Vancouver and environs, land value taxation could become a powerful accessory to urban growth management if the size of the wide-open urban land development market there were effectively constricted. What are now less desirable central areas would become more appealing to residents and merchants as incentive-driven, infill development changed the character and image of these depressed-value pockets. In the long term the central city would revitalize, as rising land values and new capital investment expanded the tax base.

Thus, tighter growth restrictions coupled with LVT will in time produce dynamic effects. Constricting the size of the sub-regional land market will have the immediate effect of pushing up land values inside the growth boundary; but a land-based tax will counter that trend by pushing them downward. Then, after the positive incentives take hold, property values as a whole will increase in re-centralized areas where infill and redevelopment have taken place.

Regulatory Adjustments

The policy objective of limiting the overall size of the Vancouver sub-regional land market to areas targeted for more intensive development is not possible unless county regulations are strengthened. The urban growth boundary, by state statute, is delineated on the basis of a projected twenty-year build-out. This boundary, though sufficient to protect most resource lands from urban conversion, is ineffective at promoting contiguous rather than leapfrog development within its limits. Indeed, speculation rises in fringe areas because of the uncertainty about precisely where and when sequential development will occur (Brown et al. 1981). If prospective development zones were clearly circumscribed around urban centers, land prices would incorporate their future urban value, while the excluded external sites would remain at their semi-rural use value.

Regulatory Issues

The following issues are raised briefly here with the aim of increasing the effectiveness of urban growth management in concert with land value taxation:

Concentric Holding Zones. Perhaps the most urgently needed requirement in the tool box of urban growth management is a mechanism to ensure contiguous, phased development emanating from established growth centers. Such a mechanism would define concentric holding zones beyond which new urban development activities (subdividing, construction, use conversion) would be restricted until a predetermined threshold ratio of developed area to total area had been exceeded. Upheld by the state's courts, a "tiered" growth control system is in effect in several New York State cities (Freilich 1992).

Large Lot Zoning. Clark County, for example, might consider abandoning large lot zoning designations, now regarded as temporary holding districts. Once the inefficient pattern of developing separate lots along county roads becomes established, the possibility of later replatting these sites within a planned urban street network is largely lost. Furthermore, land assessment practice should seriously consider the incorporation of lot sizes into comparable sales data. As a case in point, King County has adopted the assessment method of normalizing lot values on a square-footage basis. Under an LVT system, oversize residential lots would be subject to higher taxes commensurate with their potential return from land price inflation and their more extensive land use.

Land Banking. Land banking refers to the acquisition of land in advance of its intended development. The rationale for government purchase and holding of vacant parcels becomes more apparent when seen in the context of land value taxation. In some areas the market demand for permitted uses may not be maturing at the same pace that increases in the tax burden take effect. To avoid triggering premature development and forcing vacant land into low-intensity, undesirable uses through incentive taxation, a local public trust created for this purpose could offer a sale option to landowners.(4)

Major Facility Siting Provisions. Washington State in recent years has aggressively pursued economic development strategies that offer generous sales tax abatements to major employers, with no siting stipulations. Such extenuation is fraught with danger to wise land use practices, in that the impulse to minimize land purchase costs can lead to leapfrog patterns of development. The external costs of sprawl, including infrastructure expansion and commuting travel costs, constitute an enormous burden on employees and taxpayers (Tillett 1995). It would be desirable for comprehensive plans under GMA guidelines to contain a major facility siting provision, obliging firms receiving tax abatements to locate within planned urban centers, with priority given to existing centers.

Conclusion

Land value taxation appears to offer much better prospects for promoting efficient land use, dampening land price inflation, and discouraging land speculation than does the conventional property tax system. In the case of the rapidly growing Vancouver UGA, its potential for short-term results is currently limited by high increases in land values. Its potential for long-term results depends on both the effectiveness of regulatory devices to direct the location of new urban growth, and assessment practices that incorporate the unit value of sites.

In the state of Washington, a constitutional amendment would be required to allow counties the option of implementing differential rate taxation. The "uniformity clause" (Article 7, Section 1) provides that all taxes be uniform upon the same class of property, meaning that the land and improvements constituting all real estate must be taxed at the same rate. Despite this encumbrance, a coalition of Georgists and environmentalists continues to advance the proposition. The Association of Washington Cities adopted a resolution urging the

state legislature to look into a two-rate system as a means to promote central city revitalization and to help cities meet requirements under the Growth Management Act (Heller 1993).

Land value taxation as a growth management tool is not a cure-all. Further study of its consequences should address questions about its applicability to more distressed urban regions, and include dynamic effects on property values and investment decisions. Perhaps the initial step in a new approach to urban growth management is to embrace a more progressive system of property taxation. Doing this means, first, recognizing the distinction between what is privately generated value in real estate, and what in principle belongs to the community.

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AUTHOR'S NOTE

The author has completed a second study of land value taxation for the Lincoln Institute of Land Policy, in collaboration with Jim McIntire, Director of the Fiscal Policy Center, Institute of Public Policy & Management, University of Washington. That study further explores the effects of a two-rate tax on urban fringe and resource lands, as well as sub-regional equity issues.

NOTES

1. Leapfrog development, the first dimension of sprawl, is scattered, or noncontiguous, development. One practical measure of sprawl is the extent to which vacant parcels lie within a predominantly developed urban area. The primary data file obtained from the Clark County Department of Assessment shows that seventy-six square-mile sections lie wholly within the Vancouver urban growth boundary.

Comparing the numbers of vacant sites within geographic sub-areas with the numbers of developed sites yields an overall vacant site ratio of 10 percent. How the individual section ratios are distributed is the material indicator of leapfrog conditions. Rather than showing contiguous development emanating from the Vancouver center, the urban region has the look of a checkerboard pattern, with many adjoining sites skipped in favor of outlying sites, especially to the northeast. In some northeast sections more than 15 percent of the parcels remain undeveloped, while in several outer sections those ratios are under 7 percent. No doubt the siting of major new employment attractors in predominantly undeveloped areas is responsible for some of the leapfrog development.

The question might arise, what would the Vancouver urbanized area look like if recent development had occurred more contiguously, at the vacant site levels found in the center city? Using the vacant site ratio of 6 percent found within the 6-square-mile area surrounding the CBD, only 48 rather than 76 square miles would hold the current developed parcel capacity at the same net density levels.

The second dimension of urban sprawl, low-density development, has already been described in terms of land consumption patterns. During the 1990-1995 growth period, about half of the residential land area developed in Clark County was sited on lots zoned as medium (7,000 to 10,000 square feet) and large (10,000 to 40,000 square feet). By way of contrast, typical in-city lots average 5,000 to 7,000 square feet. In the 1995 assessment data, large-lot parcels, averaging over 38,000 square feet, comprise nearly a quarter of the inventory of single-family developed properties. As many as ten of the seventy-six square mile-sections within the UGA contain a majority of large-lot parcels, several of which are located midway between the CBD and the urban growth boundary.

2. The Department of Assessment's data file does not contain lot and building areas for all properties. Only 73 percent of the commercial property listings, representing less than half the total commercial assessed value, contain this information, whereas 97 percent of the single-family, residential parcel listings record square footage. Since residential properties make up an overwhelming proportion of the total parcel count, the results of an analysis on residential properties should be broadly applicable.

3. Just how significant this apparent divergence is can be determined by constructing a hypothetical distribution of the two quotients based on the overall relationship. If the BLRs were consistently seventeen times the FAILs in all residential categories, new hypothetical BLRs would be attained that corresponded precisely with the physical measure of land utilization. In this instance the new site ratios corresponding to the large-lot category would drop from 1.93 to 1.04, and small-lot site ratios would increase. (See table 1.) This group of large-lot properties would now see a jump in total assessed land value from \$ 601 million to \$ 2,136 million, as the grand total assessment remained the same. This difference amounts to an additional \$ 123,871 added to the current average land assessment of each large-lot parcel, resulting in an adjusted mean lot value of \$ 177,550, which is commensurate with lot size and building utilization.

A sample of 969 single-family properties forming a major Vancouver UGA growth sector was drawn for the purpose of measuring the degree of association between calculated FARs and BLVs. The coefficient of correlation across individual parcels is .606.

4. based on comments offered by William J. Siembieda, Ph.D., former Director, Center for Research and Development, School of Architecture and Planning, The University of New Mexico, Albuquerque, NM, October, 1995.

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Gihring is a Seattle-based consultant in housing program development and neighborhood planning. He previously taught graduate urban planning and managed international planning and development projects.

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The topic "Tender Mercies: Efficient and Equitable Land Use Change," is a market-based alternative to governmental zoning. An earlier market-based approach was a variant of the self-assessment system, which originated in New Zealand before the turn of the twentieth century (Colwell 1990b). The idea of assessing one's own real estate offers many benefits, and it has been borrowed by such diverse commentators as Sun Yat-Sen, the father of the 1911 Chinese revolution (Sun 1918), and Arnold Harberger, formerly of the University of Chicago and now at UCLA (Harberger 1974). The self- assessment system included a balanced system of options - puts and calls - that everyone would hold on the real property of others.(1) Anyone in the public or private sector could call the property of another owner at a stated premium above the self-assessed value; thus, the holdout problem would be solved, and there would be no more need for eminent domain. Similarly, an owner could put his or her property to certain others at a price somewhat below the self-assessed value. In this way, externality problems would be eliminated, and there would be no more need for zoning.

While the construction of the self-assessment system has proven to be an instructive exercise, that system has many defects that make it an unrealistic policy recommendation.(2) One defect is that self-assessment systems are incompatible with site value taxation or any "graded" difference between land and improvements taxation.(3) Another defect is that the self-assessment system would require a change in the United States Constitution. A new proposal - the tender offer system - is offered here to address some of the problems of zoning and takings. Although this system would do nothing to eliminate the need for a property assessment process, it has the benefit of allowing for any version of site value taxation. While the tender offer system might not totally eliminate the need for takings and eminent domain, it would eliminate the need for uncompensated partial takings, such as those observed in zoning. Finally, the tender offer system could be implemented with a simple statute.(4)

Even though the tender offer system would be relatively simple to implement, its effects would be profound and far reaching. In improving the equity and efficiency of zoning, the tender offer system would:

* Define and protect property rights.

* Compensate those who are injured by changes in land use.

* Eliminate the need for planning commissions and their paid staffs.

* Eliminate "not in my backyard" (NIMBY) obstructions to development and redevelopment.

* Eliminate wasteful rent-seeking activities on the part of those seeking to change land use.

* Eliminate obstructions from competitors seeking to protect their economic interests.

* Facilitate efficient change, and impede inefficient change.

* Move land to higher (not lower) valued uses.

* Provide a system of prices for compensating the loss of partial property rights.

* Minimize negative externalities by causing industrial and other low- use zones to be more compact.

* Increase the value of large scale change, thereby eliminating incentives for incrementalism.

* Eliminate the subversion of zoning for exclusionary and fiscal purposes.

* Provide a method to site all sorts of nuisances, from large-scale hog operations to nuclear waste storage.

By what magic does the tender offer system provide all of the benefits just outlined? The answer is found in George Stigler's definition of an externality: "An externality is a thing for which there is not yet a market," (Friedland 1993). If a market for partial property rights could be created, a myriad of problems would vanish.

The Current Zoning System

Governmental zoning is a policy that has unintended side effects. In fact, some might argue that all of zoning's effects are unintended. The current system seems arbitrary to many, in that it is neither efficient nor fair. This system bestows economic rents on some who petition for zoning changes while, at the same time, it injures neighboring owners by imposing new sources of negative externalities. Net benefits to the community, if any, appear to be dissipated by rent-seeking activity, which includes hiring the army of lawyers, architects, land use planners, traffic experts and public relations specialists who aid both successful and unsuccessful rent-seeking petitioners. The unfortunate distributional effects of these changes generate expensive NIMBY responses. Similarly, down-zoning, in which some previously-allowed uses are made illegal, takes property rights from some owners in order to bestow positive externalities on others. Again, the benefited petitioners spend their time and hire experts to develop appeals to the government - which is to say, to planning commissions and their city council masters. It is obvious to economists who observe this unproductive scene that what is needed is a market for partial property rights. (Serendipitously, such a market also might provide the means for eliminating full takings under eminent domain.)

Suppose that, under the current zoning system, a developer wishes to build a shopping center in the midst of a residential area. Assume that the developer holds an option to purchase a targeted site, but has not yet obtained approval for a zoning change. Under the current system, the developer's architect produces a plan and a beautiful rendering of the proposed shopping center. The developer then submits the plan and renderings to the appropriate local governmental agency, along with his appeal for a change in the zoning map. This process might typically take many months. The city's professional planning staff studies the proposal and ultimately delivers a recommendation to the planning commission. While the proposal is under study, the developer lobbies the planning staff, and provides the staff with technical reports and access to experts. On receipt of the staff recommendations, the commission begins a series of hearings on the merits of the case.

Opponents attend the meetings to argue against the proposal, and to provide their own reports and access to their own experts.(5) Among these opponents are land owners who might be injured by negative externalities. Other opponents, including those who own developed or undeveloped competing shopping center sites, attempt to protect their own economic interests. They typically do so by arguing that the proposed center will cause

existing retail facilities to become vacant hulks that will blight the planning landscape. All the while, the developer attends the necessary meetings, with his legal representatives and assorted other experts in tow.

Both sides attempt to manipulate the media. The spin that the developer puts on the proposal is that it will create jobs, provide additional property tax revenues to a strapped local public sector and give part of the jurisdiction an improved spatial distribution of shopping opportunities. The opponents counter that children will be at risk from the ensuing traffic problems, and from elements of society attracted to the proposed center. They may argue that property values near the development site will fall. Ultimately, the planning commission makes its decision, and the proposal goes forward to the city council. The lobbying continues until the city council finally makes its decision.

Although some parties connected with the development community express support for the current zoning process, or at least refrain from being openly critical, an impartial outsider can hardly view the system as anything but a disaster. Obviously, this process provides employment to planning staffs, lawyers and other experts. It also provides political gains to certain elected officials, who derive their powers from a process by which some members of society petition them for benefits - especially when the benefits come at the expense of other members of society, who must, in turn, petition for their own interests to be served. The specter of explicit corruption is raised, although corruption could occur under any zoning arrangement. Yet the current system causes corruption to be implicit in the very process, as the petitioners and their experts are typically among the most generous political contributors.

The Tender Offer System

Each of the problems attendant to the current zoning process, as illustrated in the shopping center example, can be handled through the tender offer system, under which a market for partial property rights is created.(6) How would such a market work? Suppose that every land owner were given the right to have their property spatially separated from any lower use that did not already exist nearby.(7) For convenience, simply accept the current hierarchy of "higher" and "lower" land uses specified in the typical cumulative zoning ordinance, with low density residential at the top, commercial in the middle and industrial at the bottom. Thus, for example, a home owner would have the right to prohibit industrial use on nearby lots if no industrial activity had previously existed in the close vicinity. Of course, an appropriate method for defining this vicinity would be needed. Suppose that a statute specified that the property owner had a right to exclude any new nuisance producer - defined as a lower land use - within 150 feet of any point on his parcel. This approach would be consistent with the old common law of nuisance.

Figure 1 shows a potential development site, surrounded by a shaded area representing properties for which partial property rights would have to be acquired if the project were to proceed. The figure shows why it would not always be necessary for the developer to acquire rights for whole lots. It would be necessary only to acquire rights on land located within 150 feet of the developer's parcel. Also, note that it would not be necessary to acquire rights for the public rights of way shown in the figure. While it is true that the new development might congest the public roads, the congestion's adverse effect on parcels other than the developer's would either be part of the losses for which the developer would compensate or would be ameliorated through offsite improvements provided by the developer as a result of negotiation.

A developer may, of course, negotiate with the neighbors for the right to develop a lower use in the zoning hierarchy. It seems fair to assume that most owners would want to sell if the developer were offering more than the value they placed on the rights they would be giving up. The hitch is that there may be holdouts that not only frustrate the developer, but also frustrate the majority's wishes when a preponderance of neighboring owners

wants to deal with the developer. A device to handle the holdout problem would be the two-tiered, front-end-loaded tender offer, an idea borrowed from corporate finance (Comment and Jarrell 1987). An application of this tendering approach might be as follows: if the developer could assemble rights representing, say, 80% of the land area within 150 feet of the development site, then the remaining owners could be forced to sell at, say, 10% below the price received by the voluntary sellers.(8)

Before becoming too uncomfortable with the involuntary nature of the second tier of sales, the tender offer system should be contrasted with the present governmental zoning system. The current system confiscates - takes without compensating - the full value of the partial property rights of any neighbor who is damaged by a zoning change. The proposed system would take some rights from people who own a small portion of the affected neighboring land, while compensating them at a price almost as high as the reservation prices of the voluntary sellers. While the 90% figure that is suggested as payment to the second tier is arbitrary, 90% is no doubt a good approximation of the theoretical optimum. It is important that holdouts not be rewarded but, at the same time, it is important that the discount not be so large as to be extortionate.

Furthermore, while the two-tiered offer's fairness to those who would choose not to tender their rights can be debated, concern about efficiency should also be a focal point. An important underlying concern should be the creation of a sense of urgency, but not a sense of panic. The ultimate goal would be to move land to higher-valued uses, not to stampede sellers into selling their rights for less than their reservation prices, just so they could avoid being paid discounted prices after an 80% tender. To instill the proper sense of urgency among potential holdouts, developers could make simultaneous and contingent offers in two or more neighborhoods. The idea would be to provide neighboring owners with incentives to tender their partial rights at - not above, and certainly not below - their true reservation prices.

Of course, the suggested 150-foot distance, and the 80% first-tier measure, are also arbitrary.(9) For example, some observers might argue for a wider physical buffer. But specifying a greater distance would not necessarily protect property owners injured by a proximate land use change. Typically, an externality whose source can be traced to an identifiable parcel does not travel very far beyond the originating parcel's boundary. The longer the distance to the offending use, the greater is the likelihood that owners on the periphery really would not care about the proposed development, or that they might even be advantaged by it. For example, while a household could dislike having a large retail outlet right next door, it might be happy to have such a facility located a few short blocks away. Such owners would tender their rights at a low price, and thereby would increase the likelihood that the required percentage of the needed rights would be tendered to the developer.

Thus, there might be an optimal distance, along with an optimal percentage to specify when a second tier of sales would be involuntary. The optimal distance probably would depend on the context. This refers to the gap in the zoning hierarchy between the existing use and the proposed use. For example, a small gap, such as a proposed dental office in a residential neighborhood, would call for a much smaller buffer distance than would a large gap, such as a proposed hog farm in a residential neighborhood.

Mechanics of the Tender Offer System

The developer would probably go about acquiring rights from the first tier of surrounding land owners by writing each owner a letter with an offer to pay a specified price for the partial rights needed. For example, a manufacturing concern might pay $ 1,500 per acre for the right to impose industrial odors on the affected parcels. A condition of each offer would be that the targeted owner, and most of his or her neighbors, would have to tender their rights by a particular date for the offer to be valid. If 80% or more of the needed rights were

tendered, then the second tier of rights would be acquired involuntarily under the 10% discount, or whatever terms were set by the government. If the first tier were not completed, because less than 80% of the needed rights had been tendered, then none of the affected parties would be obligated. The developer could send a new letter with a higher offer, or could simply abandon his plan to build at that location.(10) Thus, the pricing process would be similar to that in an auction with a reserve.

It might be wise to impose the same acquisition rules on the public sector as on private parties. For example, road building activities, or even hazardous waste repositories, might give rise to the need for compensation. However, it is not necessarily the case that the price paid by the public sector would be positive. Groups of owners who would benefit from a new road might volunteer to pay, especially if the public sector were to negotiate at the same time with other groups of owners along potential alternate routes. Similarly, the government could negotiate simultaneously with neighboring owners around several possible hazardous waste sites - of course, the gap between a noxious storage site and almost any other use in the hierarchy would be so great that a very wide buffer distance would be required.

Benefits of the Tender Offer System

Unlike the present system, the tender offer system would compensate those who suffer the most from land use changes. The compensation that the majority of these harmed owners would receive is an amount that they would voluntarily have chosen to accept. Thus, this new type of zoning would not generate much in the way of unfortunate distributional effects. Yet, while the favorable distributional effects are important, it is more important to recognize that the tender offer system would generate an efficient allocation of land.

Another benefit of the tender offer system is that a set of objective prices would emerge for partial property rights. These prices could form the basis for compensating property owners for government actions that would fall short of complete takings, ranging from wetlands regulation to more mundane issues such as reduced residential density. For example, if the government wished to obtain a limitation on owners regarding endangered species habitat, it could offer to buy the relevant rights. Once the owners of 80% of the affected land had agreed, the government would then take the remaining portion, compensating at a 10% discount.

With the tender offer system, there is no incentive for potential developers to waste society's resources by engaging in rent seeking. Hiring a gaggle of lawyers and experts is out of the question when the most substantial payments accrue to neighboring property owners, rather than to the public sector. Any expert testimony paid for by the developer under the tender offer system therefore would serve truly to inform affected property owners, not merely to provide political window dressing. On the other hand, part of the price paid might not be in the form of cash. Rather, it could be in the form of modifications in the proposed activities. Thus, the developer who petitioned a group of neighboring owners might be asked by that group to build berms, make roadway or traffic control improvements, agree to additional restrictions, or abandon rights in the use-changing property if there were to be a violation of the sale's terms.(11) For example, the agreement might include a specification that the loser pay the winner's legal cost in the event of a later dispute (i.e., the English rule could be introduced by contract).

Another problem solved by the tender offer system is the current system's tendency, driven by the need for appeals to the zoning bureaucracy, to produce strip zoning. Everyone has seen the busy streets with multi-block, or even multi-mile, strips of commercial uses whose backyard neighbors are all single-family homes. Strip zoning causes an excessive proportion of residential properties to share boundaries with lower uses in the hierarchy.(12) One reason why strip zoning often prevails is that bureaucrats are enamored of the idea that a parcel's use should change only after the use of a contiguous parcel has changed. Thus, developers propose land

use changes along the busiest streets, because they are rewarded, in terms of more frequent approval, for doing so. The tender offer system, on the other hand, would cause any new land uses to cluster in a tight shape that would minimize the boundary length between uses. This outcome would occur because, as neighbors gave up their rights to exclude the new use, developers would benefit from packing their new projects close to similar uses in the hierarchy, in order to avoid having to buy more rights. If there were a concave portion of the boundary along the lower-use zone, the next developer would benefit from filling that concavity, thereby eliminating the need to acquire rights along three of four sides.

The tender offer system would increase the scale of new developments. By increasing the scale and decreasing the boundary length per acre developed, developers would realize a savings, in that they could acquire rights over less land while still providing the needed property rights buffer between uses. In a competitive marketplace, this cost savings would lead to lower prices for consumers of real estate services.

Finally, the tender offer system would provide a forum within which neighbors could potentially come together to negotiate with a developer over the nature of a proposed development, as well as over the price. The neighbors might even decide that it would be in their interest to buy the developer's rights - the "Pac-Man" defense, in corporate takeover parlance - so as to facilitate the developer's exit from the neighborhood.(13) One point to keep in mind, however, is that a group of neighbors who conspired to raise the price paid by the developer might be found to constitute an illegal cartel. Viewed from the perspective of corporate tender offers, however, most cartels of this nature would be expected to elicit a noninterventionist course from the Federal Trade Commission. The government surely would note that the power of any such cartel would be held in check by developers' ability to negotiate simultaneously with owners in competing neighborhoods.

It is ironic that, by changing the direction of the property rights debate from allowing development to protecting the status quo, the tender offer system would increase the opportunity for development.

Conclusion

The market-based, private zoning device - the tender offer system - holds the promise to end any need for government-based zoning and possibly to end the need for eminent domain condemnations. It would:

* End resource waste through the elimination of rent seeking, incentives for NIMBY appeals and most zoning administration.

* End adverse distributional effects which can tear at the fabric of society by defining, and providing support for, property rights; directly compensating those who would otherwise be the losers; compensating at reservation prices rather than market values; and eliminating the forum for competitors who attempt to stop new developments.

* Radically change the spatial pattern of urban land uses through making lower-use zones more compact and causing new developments to be larger in scale.

* Eliminate the subversion of zoning for fiscal and discriminatory purposes.

* Achieve efficiency in land use.

The tender offer system is a proposal for a better allocation of property rights. There is still much research to be done, and the work will ultimately draw on a wide range of peoples' skills. Theoretical research to help address the efficiency questions, such as the appropriateness of an 80% tender offer rule or a 10% discount rule. Empirical research is needed to help with properly structuring the hierarchy of uses, in order to identify unilateral negative externalities, as well as to provide information on the appropriate buffer distances. And legal

research is needed to craft the types of statutes that would best implement a private, tender offer-based system of land use regulation.

Some researchers refuse to believe that the current system is in need of such a major overhaul, even when presented with overwhelming evidence. Their reluctance brings to mind the fellow who walked into a tavern and saw a huge fish mounted on the wall. He immediately bellowed, "Whoever caught that fish is a liar!"

This is a revised version of the Presidential Address delivered at the American Real Estate and Urban Economics Association Luncheon on January 6, 1996 in San Francisco, CA. The author wishes to acknowledge the influence of Ronald Coase, Richard Epstein, Austin Jaffe and David Mills and discussions with William Fischel, Kenneth Lusht, Henry Munneke, Neil Pearson, Jay Ritter, Joseph Trefzge and Abdullah Yavas. However, none of these individuals bears any blame for the inadequacies of this article. Neither is it implied that any one of these individuals agrees with the views expressed.

1 A call is the right to buy at a given price, and a put is the right to sell at a given price (See Colwell 1990b.)

2 There is a literature on market-based alternatives to governmental zoning. The early literature on this topic is cited and critically analyzed in Fischel (1985).

3 An owner could simply over assess fixtures and under assess land. The high assessed value of fixtures would serve to discourage anyone from exercising a call option, while those fixtures' values would not be taxed. Of course, the owner would under assess land, because that is what would be taxed.

4 Mills (1980) suggests a partially market-based system that utilizes Transferable Development Rights (TDRs) that would be even easier to implement. TDR's have primarily served as a quasi-market-based "patch" to governmental zoning to preserve low-density urban landmarks, although he reports other uses in New Jersey, Maryland and Virginia. He proposes a market in which all the government does is allocate a small amount of development rights to each property owner in its jurisdiction. If these rights were transferable, developers would assemble rights in order to develop at greater densities than their governmental allocation allows. This proposal solves the holdout problem by ignoring the spatial zoning issue.

5 Opponents of zoning change concerned with maintaining economic rents rather than the problems associated with technological externalities will resist a change from governmental zoning to the tender offer system. Opponents whose concern is for these externalities have less to fear from the tender offer system than they do from the current governmental zoning system, which takes their partial property rights and offers zero compensation.

6 Mills (1989, 1991) is the source of a proposal to sell zoning in auctions, with rebates from the auction proceeds going to all land owners equally. Again, his focus is on the quantity of the lower land use with no attention given to location. For a rationale for impact fees based on Mills' idea for selling zoning but with an eye toward handling the spatial configuration of land uses see Colwell (1996). The sale of zoning is precisely what recently has taken place with the FCC's auction of spatially defined broadcast bands. Another alternative would be to allow developers to do anything they want as long as they have some minimum scale, for example 640 acres, and as long as they do certain things at the edges of their developments (e.g., build very tall berms). Since the developers would internalize most of the externalities produced, their internal zoning could be expected to approach the optimal zoning.

7 The initial distribution of these rights would reflect the status quo of land use allocation.

8 The 80% rule is suggested here as a minimum, but it would also become the maximum as developers would naturally accept only the first 80% of partial property rights tendered.

9 An assumption here is that negative externalities are proportional to boundary length. It is implied that these externalities are unrelated to the scale of the lower use zone, holding the type of use constant. This implicit assumption should be contrasted with the assumption that is implicit in the cited papers of Mills (i.e., scale matters and boundary length does not matter). Asabere and Colwell (1984) as well as Colwell (1990b) provide a rationale for the abstraction used here. See a review of the empirical literature in Knapp (1997). On the other hand, suppose that Mills' abstraction is more useful. Prices that would emerge in the tender offer system would come to reflect the impact of scale, and there would be a brake on the growth of large scale zones of lower land uses.

10 The tender offer system's transaction costs relate to the letter writing and negotiation costs, not to the redistribution of the surplus reflected in the price of the partial property rights. Zero transaction costs are not a necessary condition for the operation of the Coase Theorem, however it is necessary that transaction costs do not vary with the quantity of property fights conveyed (i.e., that the transaction costs, not the price, for going from single-family to multi-family is the same as for going from single-family to industrial). It is also necessary that the magnitude of the transaction costs is not larger than the total surplus generated by the transaction.

11 Development fees, exactions and land dedications can become entirely privatized through the tender offer system.

12 Strip zoning also maximizes traffic congestion.

13 This interesting, if infrequently used, takeover defense is discussed in many corporate finance texts. See, for example, Rao (1995) or Emery and Finnerty (1991).

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GRAPHIC: Chart; Illustration
IAC-CREATE-DATE: February 10, 1998
LOAD-DATE: February 11, 1998

Evidentiary Exhibit Number 141

Chicago Tribune

December 6, 1997 Saturday, WEST COOK SPORTS FINAL EDITION

SECTION: NEW HOMES; Pg. 12; ZONE: W; Realty Q&A.

LENGTH: 833 words

HEADLINE: COMMON PROBLEM;

ONE OWNER WANTS TO SELL THEIR HOUSE, THE OTHER OWNER DOESN'T

BYLINE: By Robert J. Bruss, Tribune Media Services.

BODY:

Q--About six years ago, I bought a house with my best friend. Last month he told me he wants to sell the house and move away from this area. But I don't want to sell--I have a good job, love the house and don't want to move. However, I can't afford to buy my co-owner out. He says he can force me to sell by taking me to court. We hold the title as tenants in common. Can I be forced to sell?

A--Yes. A major weakness of holding real estate titles as tenants in common or joint tenants (except tenancy by the entireties between husband and wife) is that one owner can force a sale of the property even when the other owners don't want to sell.

It is called a "partition" lawsuit. If you owned land and one owner wants to sell but you don't, the court can order the land partitioned between the owners. However, partitioning a house isn't practical, so the court can order the house sold with the sale proceeds divided according to each owner's share. I suggest you hire a real estate attorney to protect your legal rights.

Q--We are considering refinancing our home loan, which has an 8.35 percent interest rate. Our mortgage broker says we can save about $110 per month by refinancing with a so-called "no cost" refinance. But we're wondering if interest rates will drop further and if we should wait to refinance. What's your advice?

A--Grab that refinance deal. If interest rates drop further, you can refinance again.

I'm sure you realize that the so-called "no cost" refinanced mortgage really isn't. The mortgage lender raises the interest rate to include the normal refinance costs such as loan fee, title fee, appraisal, credit check and other mortgage expenses the borrower normally pays.

The "no cost" mortgages are ideal for refinancing because those up-front fees are not immediately tax deductible on a refinance but the mortgage interest paid is fully tax deductible.

Please be sure the so-called "no cost" refinanced mortgage does not contain a prepayment penalty. Some mortgage lenders include prepayment penalties for two or three years to discourage frequent refinancing. Without a prepayment fee, if interest rates drop further then you will be free to refinance again.

Q--We carried back a second mortgage for our home buyers about three years ago. All went well until about four months ago, when the payments to us stopped. I phoned the borrowers and learned the husband lost his job. Also, the wife said they are now separated. She wasn't sure if they would be selling the house. How long should we give them to decide to either make up the missing payments or sell the house?

A--One minute more. Then start foreclosure. The chances of that couple making up your payments are very remote after missing more than two payments.

Filing the foreclosure papers will motivate the borrowers to do something, such as list the house for sale. If they don't take any action to cure the default and reinstate your mortgage, at the foreclosure sale you either get the house back (to earn a second profit) or a bidder will pay off your mortgage. Either way, you win. A local real estate attorney can handle the foreclosure details.

Q--As a real estate broker for about 12 years, I sometimes encounter listings that won't sell no matter what marketing methods I use. For example, I've got a very attractive one-bedroom condo listed in an upscale complex, priced right, but it hasn't sold in over four months. My sellers are getting anxious, blaming me. The problem is, this condo fronts on a busy street and many prospects don't like the traffic. But when the windows are shut, you can't hear the automobile noise. Any ideas sales ideas?

A--The one technique I've never seen fail, when properly used, is to advertise it for sale on a lease with option to purchase.

For example, you might headline your classified ad: "$5,000 moves you in; rent to own." Then describe the condo's features and the monthly rent; give the Sunday open house hours, the address and your phone. Be sure the lease-option gives a generous rent credit, at least 33 percent, toward the purchase price.

The higher the rent credit, the greater the probability the tenant will buy the condo during the one-or two-year option period.

Q--I am thinking of moving out and renting my large house to tenants. Do I have to notify the IRS when I do so?

A--No. Just move out and begin collecting rent from your new tenants. Of course, the rental income you receive must be reported on Schedule E of your income tax.

This is the same place you also report applicable deductions such as mortgage interest, property taxes, insurance, maintenance and repair costs, and depreciation deductions. Your tax advisor can give you full details.

PLEASE NOTE: Real estate laws vary from place to place. Be sure to check the laws of your state and municipality before making decisions on real estate matters.

Write to Robert Bruss at Tribune Media Services, 435 N. Michigan Ave., Chicago, Ill. 60611.
LOAD-DATE: December 6, 1997

Evidentiary Exhibit Number 142

Chicago Tribune

November 21, 1997 Friday, NORTH SPORTS FINAL EDITION

SECTION: YOUR PLACE; Pg. 16; ZONE: C; Resale Q&A.

LENGTH: 1064 words

HEADLINE: PROFIT SHELTER;

JOINT TENANTS CAN SAVE UNDER 1997 TAX ACT

BYLINE: By Robert Bruss, Tribune Media Services.

BODY:

Q--My friend and I own our house in joint tenancy. If we sell it, since we have both owned and lived in it for more than two of the last five years (as required by the 1997 Tax Act), do we claim a joint $250,000 tax exemption ($125,000 each) or must one owner claim the entire $250,000 exemption? If we don't sell and one joint tenant owner dies, does the surviving owner get a new basis stepped-up to market value on 50 percent or the home's entire market value?

A--If two principal residence co-owners can each meet the 1997 Tax Act's ownership and occupancy requirement of at least two of the last five years before the sale, each can claim up to $250,000 of tax-free profits. That means up to $500,000 total profits on the sale of your home are tax-free.

If you decide not to sell, but one of the joint tenants dies, the surviving joint tenant gets a new basis stepped-up to market value on the half received from the deceased joint tenant.

But husbands and wives in community property states should note that their situation is different. Thanks to Revenue Ruling 87-98, the surviving spouse can get a new basis stepped-up to market value for the entire community property home. Consultation with your tax adviser is recommended.

Q--In 1993, we sold our home and deferred our capital gains tax because we previously used the "over 55 rule" $125,000 home sale tax exemption. We then bought our current house, where we have lived almost five years. Where do we stand with the new $500,000 tax exclusion? In January 1997, our attorney advised us to put our home into my wife's revocable living trust. Does this affect anything?

A--Your prior use of the old, now-repealed "over 55 rule" $125,000 home sale tax exemption does not disqualify you or your wife from using the 1997 Tax Act home sale benefits. Because you deferred tax in 1993 on the sale of your previous principal residence, the new tax law's generous exemptions apply to that deferred profit, too.

Although title to your principal residence is now in your wife's living trust, that's all right because only one spouse need hold title to the principal residence. Because you both meet the two-out-of-last-five-years occupancy requirement, if you file a joint tax return in the year of the sale, you and your wife can claim up to $500,000 tax-free profits, including the profit deferred from your previous home sale. Please consult your tax advisor for details.

Q--Three years ago, we bought our home for $170,000 with a 5 percent down payment, having just arrived from out of state for a new job. Our credit is flawless, income good and other debt non-existent.

We are considering refinancing our 30-year ARM to a 15-year fixed-rate loan with the same lender. But we still own our former home, now a rental, which continues to increase in its property tax assessment but

deteriorate as a rental. When I applied to refinance our principal residence, I was told to "leave things alone" because we should be earning more on our rental. Am I getting good advice?

A--No. Unfortunately, many mortgage lenders discount rental income. Shop around. Not all lenders are as bad as the one who advised you not to refinance. Perhaps he didn't want to get rid of that ARM (which lenders love).

There are hundreds of mortgage lenders eager for your business to refinance your principal residence. Many won't discount the rent you receive from your rental house.

Incidentally, if that rental house isn't bringing in enough rent, why not sell it to your tenant on a lease-option?

Q--My husband is 75 and retired. He watches the TV court channel during the day and sports at night. Because he is hard of hearing, he turns the volume up so loud it shakes the whole house. We have not been on speaking terms for over a year. If I move into a condo I've owned since 1991 and share it with my renter, giving her a rent reduction, and make it my principal residence for 24 months, can I then sell it and claim up to $250,000 tax-free capital gains?

A--New Internal Revenue Code 121, which contains the new $250,000/$500,000 home sale tax exemption, does not prohibit sharing a principal residence with a renter. After living there at least 24 months, you would appear to qualify for the $250,000 sales exemption. Please consult your tax adviser for details.

Q--My husband and I own a rental house we acquired in an Internal Revenue Code 1031 tax-deferred exchange two years ago. We want to exchange it for a house, where we eventually would live. Can we use an IRC 1031 exchange to use the large equity in our rental house to acquire another house? If so, how long must it remain a rental house before we can move in and convert it to our principal residence?

A--Your question is frequently asked. Nobody knows the answer for sure. It is not explained in the Internal Revenue Code, the Regulations or Tax Court decisions. Most CPAs and tax attorneys advise renting a property at least 6 to 12 months after acquisition in a tax-deferred exchange before converting it to personal use.

Q--When I bought my home four years ago with a 7.5 percent mortgage, everything was fine. But two years ago, the lender said my escrow account for property taxes and insurance was $196 short. They said I could pay it all at once or they would divide it up and add it to my monthly payment. The next year the same thing happened. Why does the bank come up short and try to stick it to customers like me?

A--You and millions of other homeowners have an escrow account for property taxes and insurance where, once a year, your mortgage lender estimates the funds needed to pay these expenses when due. You are then expected to pay one-twelfth of these increasing costs each month along with your mortgage payment.

Be happy. Most borrowers complain that their lender charges too much for their escrow account. Your lender seems to be charging too little and giving you a year to repay the deficit in your escrow account. There's nothing wrong with that, since you owe the taxes and insurance.

Have a question about real estate? You can write to Robert Bruss in care of Tribune Real Estate Features Service, 435 N. Michigan Ave., Suite 1400, Chicago, Ill. 60611. Answers will be provided only through the column. Please note that laws vary from state to state and area to area. Consult an attorney for specific legal advice.

LOAD-DATE: November 21, 1997

Evidentiary Exhibit Number 143

Chicago Tribune

October 11, 1997 Saturday, WEST COOK SPORTS FINAL EDITION

SECTION: NEW HOMES; Pg. 28; ZONE: W; Realty Q&A.

LENGTH: 1320 words

HEADLINE: RENTAL GUIDE;

HOW TO DETERMINE HOW MUCH HOUSE INCOME SHOULD BE

BYLINE: By Robert J. Bruss. Tribune Media Services.

BODY:

Q--I am moving away from the area for about a year on a training assignment in Europe. Since I want to return to my home, I plan to rent it while I'm gone. How can I determine the fair market rent? I'm willing to rent it to a responsible family at a below-market rent. Should I call a Realtor to rent it for me? How much will it cost?

A-- Here's a very rough guideline: A house should rent for 1 percent per month of its fair market value. That means, for example, if your house is worth $100,000, it should rent for $1,000 per month.

However, in most cities it is virtually impossible to get that much rent. But in a few communities, such as St. Louis, houses rent for more than 1 percent per month of market value.

To find out the fair market rent for your house, I recommend you consult several local Realtors who specialize in home rentals. After inspecting your home, they can easily recommend a reasonable rent.

By hiring a Realtor to rent your residence, you should expect top quality professional service. This will include showing your home to qualified prospects, receiving an application and credit report on the prospect, and obtaining the first and last month's rent, plus a security deposit. For this service, expect to pay the rental agent a fee of approximately 5 percent of the annual rent. Of course, this fee is negotiable.

Q--Our home is worth about $220,000. The mortgage is paid down to around $87,000. We want to refinance to reduce our interest rate and get some cash so we can add a family room, but a friend told us we will owe tax on the money we receive. Is this true?

A--No. Your friend is mistaken. Mortgage refinance money is not taxable. There is a very good reason; You must pay it back. It would hardly be fair to tax you on money that must be repaid.

Q--I own a rental house in California on which I have been carrying earthquake insurance. Recently I received the renewal bill for this policy and it is outrageous. Also, it carries a 15 percent deductible. Should I carry earthquake insurance on California property?

A--I agree the premiums on California earthquake insurance policies have become outrageous. I dropped earthquake insurance on my properties because of the high premiums and the very high 15 percent deductible amount. If these properties are severely damaged by an earthquake, I figure the mortgage lender just bought the real estate.

Q--Recently you told a homeowner if she decides to rent her house to tenants, instead of selling it, she can take an income tax deduction for depreciation. I've never heard of that tax deduction. What is depreciation?

A--Depreciation is a non-cash bookkeeping tax deduction for estimated wear, tear and obsolescence on business and rental properties. Residential rental property must be depreciated over 27.5 years on a straight-line basis.

That means the property owner divides the adjusted cost basis of the building by 27.5, not including land value, which is not depreciable, and deducts that amount each year as if it were a cash expense.

Depreciation is the best income tax deduction there is, because it doesn't require any cash payment, such as mortgage interest, fire insurance and property taxes.

Q--Lately you've run several letters from home loan borrowers who are frustrated trying to deal with their out-of-state "scum bag" loan servicers. The only solution is to get tough, as I did.

My mortgage servicing was sold, for the third or fourth time. The new loan servicer in Texas said I was short $540 in my escrow impound account for property taxes and fire insurance premiums, but according to my calculations, my escrow contained about the right amount. I phoned and was rudely treated by a young woman who barely knew what a mortgage was. When I asked to speak to her supervisor, she hung up. I then wrote a complaint letter to the loan servicer's president, as you often suggest. A friend told me to ask for the loan servicer's license number in my state. It turned out the loan servicer is not qualified to do business in my state! My loan servicing was quickly transferred to a nearby loan servicer who has not said a word about increasing my escrow deposit.

A-- Congratulations on getting tough with your "scum bag" loan servicer. Recently I have received many letters complaining about loan servicers demanding unjustified increased payments into property tax and fire insurance escrow impound accounts.

For example, I have in front of me a letter from a California property owner whose Florida mortgage loan servicer is demanding an increase in the escrow account balance based on a new RESPA (Real Estate Settlement Procedures Act) law. When the borrower asked for a copy of the new law, she was told to pay $40 or "go to the library."

Escrow impound accounts are "free money" for loan servicers. That's why they're so eager to extract as much as possible from borrowers. In most states, unless it is a VA, FHA or PMI (private mortgage insurance) home loan, borrowers aren't even required to have escrow accounts and can cancel them at any time.

Your tactic of asking for the loan servicer's license number in the state where the property is located is excellent. I did that a few years ago with Atlantic Mortgage and Investment Corp. in Jacksonville, Fla., which was not licensed to do business in California, where my property was located. As a result, the owner of my mortgage, Fannie Mae, transferred my loan servicing to an excellent in-state loan servicer.

Borrowers should get tough with their out-of-state loan servicers who are improperly demanding escrow increases. Phone or write them to ask: (1) Who owns my mortgage (such as Fannie Mae, Freddie Mac, Ginnie Mae, etc.); and (2) what is your license number in my state? However, banks can do loan servicing nationwide. Then follow up. As you learned, it pays to complain.

Q--For 18 years I've lived in a 48-unit condo, in which 31 units are now rented. The result is poor maintenance, excessive noise and failure to enforce the CC&Rs (conditions, covenants and restrictions). For example, a one-bedroom unit is rented to a father with five children, ages 3 to 14. One day he disappeared, leaving the 14-year old in charge of four small children. He was in jail for six weeks. We called the police, who had the county take the children. But now they're back. The so-called professional management company is doing a terrible job. The board of directors won't enforce the CC&Rs. What should I do?

A--Have a meeting of all the owner-occupants to take action. Attend the board of directors meetings. Speak up. Run for election to the board. Then enact and enforce reasonable rules for the benefit of everyone.

If that doesn't work, sell your condo. Another alternative is to move out and rent your condo. When a "neighborhood" goes bad, as your condo complex obviously has, it's time try to improve conditions or get out.

Q--I hope and pray you can help me with a problem. My adult daughter will not remove her name from my home, which I want to sell. As long as her name is on the deed, I can only rent it. My lawyer says there is no loophole. Although I am 74, I cannot obtain a reverse mortgage because my daughter is on the title. What can I do?

A--Your situation shows why parents should not add even their adult children's names to their real estate title. Like good wine, kids can go bad!

One possibility is for you to sue your daughter in a partition lawsuit. The court can order the property sold with the sales proceeds distributed according to each owner's share of the property. Perhaps you need to consult a another real estate attorney.

PLEASE NOTE: Real estate laws vary from place to place. Be sure to check the laws of your state and municipality before making decisions on real estate matters.

Write to Robert Bruss at Tribune Media Services, 435 N. Michigan Ave., Chicago, Ill. 60611.
LOAD-DATE: October 13, 1997

Evidentiary Exhibit Number 144

Chicago Tribune

October 4, 1997 Saturday, WEST COOK SPORTS FINAL EDITION

SECTION: NEW HOMES; Pg. 20; ZONE: W; Realty Q&A.

LENGTH: 1074 words

HEADLINE: NO RELIEF;

OFFICE-AT-HOME TAX DEDUCTIONS NOT EASED UNTIL 1999

BYLINE: By Robert J. Bruss, Tribune Media Services.

BODY:

Q-- I work out of my house as an "outside salesman." I use one bedroom for my office where I have my files and a desk. Last year an IRS auditor denied my home office deductions because, she said, I spend most of my time calling on customers. That's true. But a fellow salesman told me a few weeks ago that we can now deduct our home office expenses again. Is this true?

A--Not exactly. The good news is that the 1997 Tax Act contains a provision liberalizing home office expense deductions when the taxpayer conducts "substantial administrative or management activities of the trade or business." But the bad news is this provision does not take effect until the 1999 tax year.

Until then, home office business expenses are tax deductible only if your residence is your "principal place of business." Unfortunately, as an outside salesman, your primary business location, according to the IRS, is outside the home calling on customers. Please consult your tax advisor for further details.

Q--My husband and I have been married almost two years. We save $450 per month for our home down payment fund. Just for fun, some Sunday afternoons we visit new houses and Realtor resale open houses. It seems home prices aren't getting any cheaper.

Last weekend we inspected a brand new house where the developer is offering a lease with option to buy. The salesman said we would have plenty of down payment money after a year, from our savings and the lease "rent credit," with which to buy the house. We've never heard of this plan before. Do you think we should continue saving for a bigger down payment or buy that home now?

A--Of course, I can't recommend the desirability of that particular new home. But lease-options are an excellent way to buy a new or resale home after renting it for a year or two to build up a rent credit.

You are to be commended for your excellent down payment savings program. However, there are so many low- and nothing-down mortgage programs now available it doesn't make sense to keep saving while home prices rise. Whether you lease-option or buy with a no- or low-down payment mortgage, I recommend you stop wasting money on rent.

Q--Thanks for your article a few weeks ago explaining the real estate highlights of the 1997 Tax Act. But I didn't understand the part about "depreciation recapture." As the owner of six rental houses, do I need to know about this?

A--Yes. When you eventually sell those rental houses, hopefully at a profit, part of that profit will be taxed at the new long-term capital gains tax rate of 20 percent. But the portion of your profit that results from your depreciation deductions for estimated wear, tear and obsolescence will be "recaptured" and taxed at the new 25 percent depreciation recapture rate.

For example, suppose you bought a rental house for $100,000. While you owned it, you deducted $25,000 depreciation, bringing your adjusted cost basis down to $75,000. Then you sell it for $160,000 net. Your profit is $85,000 ($160,000 minus $75,000). Sixty thousand is taxed as a long term capital gain at the new 20 percent rate. But the $25,000 recaptured depreciation is taxed at a new 25 percent rate. Ask your tax advisor to explain further.

Q--My wife and I bought a townhouse about three years ago. We like it very much, but it's too far from our jobs. We waste almost an hour each way driving to and from work. Our goal is to buy a house closer to our jobs. Should we keep our townhouse as a rental investment? Or should we sell it before we buy a house?

A--Your first step is to decide how you are going to pay for the house you want to buy. If you have cash for a down payment, your next step is to get preapproved for a mortgage. The lender will probably preapprove you for a larger mortgage if you agree to sell the townhouse rather than renting it.

After you plan the financing for the house you want to buy, then start looking for houses to purchase. If you decide to sell the townhouse, get it sold before you make a purchase offer to buy a house. You don't want to be under pressure to sell the townhouse so you can afford to buy a house.

Q--Is it always necessary to hire a lawyer when selling or purchasing a home? My mother will be putting her home up for sale in Florida, through a Realtor. If she later buys a home near me (also through a Realtor) does she need a lawyer?

A--You ask a very controversial question. Speaking as a lawyer, I don't think home buyers and sellers need to hire a lawyer in a typical home sale or purchase. I've bought and sold dozens of houses for personal use and investment, but I've never encountered a lawyer representing the other party.

However, I've received many letters to this column about "deal killer" lawyers who messed up home sales and purchases. But there may be situations where a real estate lawyer is needed to solve a legal problem for the buyer or seller. Since your mother will be wisely hiring a Realtor to represent her, let the Realtor advise whether a lawyer is needed in the specific situation.

Q--As a Realtor, I look forward to your articles because they tell me what home buyers and sellers want to know. But I don't necessarily agree that overpricing is usually the reason a home doesn't sell. I've been selling homes about 14 years and have seen many other reasons why they don't sell. My speciality is listings. I make sure the asking price is reasonable. But no matter how hard or smart I market the house, sometimes it doesn't sell for reasons such as uncooperative sellers (especially when there is a divorce), refusal to paint and fix up, unpleasant smells (such as from cooking or pets), bad location, bad schools, sellers who insist on hovering while prospects inspect the house, and greedy sellers who demand all cash. I just thought you should know overpricing isn't always the reason a home won't sell

A--Thanks for sharing your experience. I fully agree the reasons you list often stop a house from selling quickly. However, if the asking price is reduced low enough to compensate for drawbacks, the house will eventually sell.

The new Robert Bruss special report "How the 1997 Tax Act Benefits Homeowners and Real Estate Investors" is available for $4 from Robert Bruss, 251 Park Road, Burlingame, Calif. 94010. Credit card orders are welcome at 1-800-736-1736.

Write to Robert Bruss at Tribune Media Services, 435 N. Michigan Ave., Chicago, Ill. 60611.

LOAD-DATE: October 4, 1997

Evidentiary Exhibit Number 145

Orlando Sentinel (Florida)

September 28, 1997 Sunday, METRO

SECTION: HOMES; Pg. J15

LENGTH: 1253 words

HEADLINE: WORTH A TRY: ASK 1ST BUYER FOR RELEASE FROM DEAL

BYLINE: Robert Bruss,Tribune Media Services

BODY:

QUESTION: Our house was listed for sale almost three months ago. The listing was about to expire in two weeks. Thereal estate agent called to tell us another agent had a purchase offer to present to us. Although the offer was about $12,000 below our asking price, and we were very disappointed, our agent suggested we accept it. We did. The next afternoon our agent called to tell us another agent (who didn't know about our "sale" the night before) had a better offer. It was only about $4,500 below our asking price. How can we accept this second offer and get out of the first sale?

ANSWER: You can accept the second offer contingent upon being released from the first sale. If that is acceptable to the second buyer, then your listing agent should ask the first buyer for a written release. You might be surprised.

Perhaps the first buyer is having a case of buyer's remorse and would like to get out of buying your home. It won't hurt to ask. However, be sure the details are in writing so there is no misunderstanding.

Ask for a discount

Q: My wife and I are buying a house some friends purchased last January. They are selling because of an unexpected job transfer. The mortgage company says we can take over the mortgage for only a $100 assumption fee. But the title insurance company wants a fee of $1,232. The company refuses to transfer the title insurance policy our friends bought last January.

Do you think title insurance is aripoff?

A: Yes. Title insurance is expensive, typically about 1 percent of a home's sales price. However, you need a new title insurance policy in your name just in case your sellers incurred any unexpected liens, such as for unpaid taxes, while they owned the house.

Because title to the house you are buying recently was searched and found to be in good condition, ask the title insurer for a discount. Some states don't allow title insurance discounts, but many do.

Hire a buyers agent

Q: I am a single mother, looking to buy a modest house for myself and my two sons. Recently at an open house, I saw a nice two-bedroom house with a den, which would be ideal for us. However, when the real estate agent learned I don't have much for the down payment, she said she couldn't help me.

I then explained I am pre-approved for a mortgage. But when I questioned the asking price, which I thought was high, she refused to help me make an offer below the asking price. I can't prove it, but I believe she may have been discriminating against me because I am a black single woman. The house is still available and I want to buy it.

What should I do?

A: Rather than argue with the listing agent who was holding the open house, I recommend you hire your own buyers agent to prepare your purchase offer. Whereas the listing agent could have earned all the sales commission, now she will get only 50 percent because your buyers agent will get the other half.

A listing agent has a fiduciary duty to the seller to present all purchase offers that materialize during the listing term. That agent breached her duty to the seller by not presenting your offer, as you are obviously qualified to buy that home.

However, it is not to your advantage to raise that issue or the discrimination problem. Your buyers agent can best represent you in this home purchase.

Beware of penalty

Q: We bought our home just over two years ago. Recently we received a call from the mortgage banker who arranged our mortgage. She recommends refinancing with a no-cost mortgage at a fixed rate of 7.85 percent interest. This will reduce our monthly payment about $92. However, one drawback is this loan has a prepayment penalty for the first three years.

Do you think we should refinance now?

A: Homeowners who are considering a refinanced mortgage should consider a so-called "no cost mortgage." That means there are no upfront costs for a loan fee, appraisal, title fee and credit report expenses. These fees are included in the mortgage interest rate.

No-cost mortgages, which have a slightly higher than normal interest rate, are advantageous for refinancing. Unlike tax-deductible loan fees paid to obtain an acquisition loan at the time of home purchase, loan fees on a refinanced mortgage are only tax deductible over the mortgage's life, so there's no immediate tax break for paying an upfront loan fee.

However, the loan your mortgage banker suggests has a major drawback, that prepayment penalty during the first three years. This is undesirable if you decide to sell the home or refinance again. Ask if the prepayment penalty can be waived. If not, keep shopping unless you are absolutely certain you won't be refinancing again or selling your home in the next three years.

Avoid tenant eviction

Q: I own a rental house, which I rented to a single man. Until recently, he had paid his rent on time. Now he is 10 to 15 days late each month. Recently he has been disturbing the neighbors, who have phoned me about the late-night noise from his parties. I've asked him to keep the noise down, but that hasn't helped. He is on a month-to-month rental agreement.

Should I evict him?

A: You must decide if you want the tenant to leave because your talk with him hasn't produced results. If you decide he should leave, avoid eviction, which can be expensive for you.

Try to get the tenant to agree to vacate by a definite date. If he won't agree, then giving him a written notice to move starts the procedure.

This notice to move may cause him to stop paying rent, thus forcing you to evict. Eviction usually takes 30 to 60 days, thus resulting in "free rent" before the court renders judgment and the sheriff removes the tenant. By then, your tenant and his friends may have caused considerable damage.

To avoid eviction, I suggest you offer the tenant moving money. Explain to the tenant how much an eviction will cost in legal fees and say "I'd rather pay you the money if you'll move out quickly."

Paying $500 to $1,000 to the tenant is usually sufficient. But don't deliver the money until the tenant has moved out and you have inspected for damage.

Rental agent's fees

Q: I own a rental house in Florida where I plan to retire someday. It has been rented to the same tenant for six years, but she recently notified me she's moving out. I contacted a nearby real estate agent's office, and he wants a rental fee of 5 percent of a year's rent to find me a new tenant. He charges extra for supervising cleanup and painting.

If he collects the monthly rent, his management fee is 10 percent of the gross rental income. Do these fees seem high to you?

A: No. Those property management fees for renting and managing a single-family house seem quite reasonable if the agent gets your house rented quickly. Losing one or two months' rent will be far more expensive.

Insist on 12-month lease?

Q: I recently inherited a six-unit apartment building, and there is a vacancy. My attorney said I should insist on a 12-month lease, but I find the prospective tenant wants month-to-month leases.

Should I hold out for a year's lease?

A: There is no right or wrong answer to your question. As a longtime landlord, I prefer a one-year lease when renting to a new tenant, which lets me know the tenant intends to stay at least a year.

I've learned, however, that if tenants want to move out, they won't hesitate to break a lease. Perhaps I'm mellowing in my old age, but now I'll accept a month-to-month tenancy from a well-qualified tenant with a stable rental history.

COLUMN: REAL ESTATE MAILBAG

LOAD-DATE: September 28, 1997

Evidentiary Exhibit Number 146

The Post and Courier (Charleston, SC)

September 14, 1997, Sunday, SUNDAY EDITION

SECTION: B, Pg. 1

LENGTH: 1238 words

HEADLINE: Intended clarification muddies property tax law

BYLINE: ARLIE PORTER; Of The Post and Courier

BODY:

A change in state law, little noticed at the time it was passed three years ago, could save new home buyers thousands of dollars.

Or, it could do just the opposite.

While the savings - or costs - remain unclear, what is clear is this: The change is creating one mean migraine across the state. It not only affects real estate attorneys, banks, and developers, but virtually everyone who sells or buys a home.

"The current system is not user-friendly. That's for sure," said S.C. Department of Revenue Director Burnett R. Maybank III, who agrees with attorneys that the law needs to be changed. Here's the problem:

Before the law was changed, homeowners could get the coveted 4-percent tax rate on homes they occupied. To get it, they had to live in the house as of Dec. 31 prior to the year tax bills were sent out.

If they didn't live in the house that far in advance, they were subject to the higher 6-percent tax rate, the same rate charged on rental properties.

The difference between the two rates is substantial.

Take, for instance, a $ 100,000 home in the city of Charleston. At the 6-percent rate, the property taxes on the home are $ 1,642. At 4-percent, the taxes are $ 662, a savings of $ 980.

New home buyers complained because they could have to wait a full year to qualify for the 4-percent tax rate.

So the state legislature changed the law in an attempt to make it easier for people to get the 4-percent rate. The new law allows residents to get the 4-percent rate anytime during the tax year.

What seemed so simple, however, turned out to add confusion to the already arcane realm of assessments, tax rates and property taxes.

Before, real estate attorneys knew what the tax bill would be, and pro-rated the bills for the year between the seller and buyer.

Now, however, a home buyer might not apply or qualify for the 4-percent rate, and would be stuck at the 6-percent rate - with perhaps no means of getting more money from the previous owner who wouldn't want to pay the higher tax rate anyway.

After all, the seller had qualified for the 4-percent rate when he or she lived in the home before selling it.

Or take these examples. If someone sold his home to an out-of-state buyer for use as a vacation home, the seller would be stuck with having to pay the 6-percent rate - though he had lived in the home.

The opposite could happen as well. Someone renting a house could sell it to someone who will live in it. In this case, the seller would benefit by paying the 4-percent rate instead of the 6-percent rate.

Developers too can take advantage of the new system. If they sell a house, they get the 4-percent rate for the entire year instead of paying the 6 percent rate prior to the house being sold.

In every case, attorneys cannot predict how a home will be taxed, so they have no idea what to charge the buyer and seller in the closing.

This is what has them fuming.

"It's a huge problem, and that causes it to be a problem for the public," said real estate attorney Leonard Krawcheck. "It's terribly confusing. One of the things important about taxes is that you know the rules of the game and can estimate on a realistic and fair basis what the taxes are going to be."

County auditors will have to send out more than one tax bill reflecting different tax rates and that's sure to confuse homeowners more, said Nancy Bloodgood, a deputy Charleston County attorney.

"There will be more (people) hurt by this than (helped)," Bloodgood said.

Maybank said the change was meant to give tax relief to property owners. In this case, however, the simplicity of the previous system outweighs that relief, he said.

Legislation to change back to the previous system was entered in the General Assembly last year but did not get anywhere. The revenue department will place a higher priority in getting the legislation through next year, Maybank said.

"While it (the change) was taxpayer friendly, it did add an undue layer of complexity, and simplicity is paramount," Maybank said.New, old tax law affect real estate

Here are two scenarios describing the changes in state law and how its interpretation affects home sellers, home buyers and developers. Under state law, homes that are occupied as the primary residence of the owner qualify for a 4 percent tax rate. All other residential property, including rental property, is taxed at 6 percent.

Scenario 1: An existing home is owner-occupied on Dec. 31 and is sold six months later to another individual.

Old law

The tax rate assessed on property was established on Dec. 31 for the following year. If a house was occupied by the owner on that date, it qualified for a 4 percent rate for the entire year, regardless of whether it was sold or changed use during that year.

Conversely, if it was a rental property, or not lived in by the owner on Dec. 31, it was assessed a 6 percent rate for the entire year, even if it was sold and the new owner began living in the home.

Advantage: All parties, including the closing attorneys, knew what the tax rate was and could prorate the estimated taxes if a property was sold during the year.

Disadvantage: If a rental or unoccupied home was sold during the year to someone who would qualify for the lower 4 percent owner-occupied tax rate, the new owner still paid taxes at the 6 percent rate for the first year and had to apply for the lower tax rate for subsequent years.

Additionally, someone who bought a home for rental use during the year would enjoy the lower 4 percent rate if the previous owner had lived in the house and qualified for the lower rate.

New law

The tax rate is not tied to occupancy on the previous Dec. 31, and a new home buyer can apply for the lower 4 percent tax rate any time during the year. Whenever property is sold, however, the tax rate automatically is changed to 6 percent and remains at that level until the new owner applies and qualifies for the lower tax rate.

Advantage: A new homeowner can qualify and pay the lower tax rate for the full year regardless of how the property was used by the previous owner.

Disadvantage: The home seller, home buyer and attorneys cannot accurately determine what the prorated taxes will be at the time of closing since the rate is dependent on future actions. If the new owner moves and decides to rent out the home for the rest of the year, the tax rate goes to 6 percent for the entire year. Also, if the new owner bought a former rental property and later qualified for the 4 percent rate by living in the house, the previous owner would benefit from the lower rate even though he had not lived in the house.

Scenario 2: A developer sells a home in June, and the new owner plans to live in it as his primary residence.

Old law

Because the property was not owner-occupied on the previous Dec. 31, it was taxed at 6 percent for the entire year regardless of the intended use by the new owner.

New law

The new owner, if he plans to live in the home, can apply for the 4 percent tax rate anytime after the purchase. The lower rate would be assessed for the whole year, including the months when it was unoccupied and owned by the developer. The developer would, therefore, also benefit by paying the lower 4 percent rate for the time he owned the property.

Compiled by Arlie Porter

Arlie Porter covers Charleston County. He can be reached at 937-5548.

LOAD-DATE: September 18, 1997

Evidentiary Exhibit Number 147

Orlando Sentinel (Florida)

September 7, 1997 Sunday, METRO

SECTION: HOMES; Pg. J17

LENGTH: 933 words

HEADLINE: LOW PURCHASE OFFER IS PROPER FOR HOME NEAR NOISY SCHOOL

BYLINE: Robert Bruss,Tribune Media Services

BODY:

QUESTION: We are considering buying a house we like and can afford. The problem is, it has been listed for sale almost six months. Our realty agent who showed it to us (not the listing agent) says it hasn't sold because it's across the street from a noisy elementary school.

Because we have two children, ages 5 and 7, that would be an advantage for us. However, my husband's company probably will transfer him within five years, so we're thinking it might be difficult to resell this house.

Is buying a house across the street from a school a bad idea?

ANSWER: Homes adjacent to schools often do not appreciate in market value as much as those on quiet side streets. Such a location limits the number of potential buyers when you resell.

Most home buyers with children want to be near a school but not right across the street. If you decide to buy that house, I suggest you make a low purchase offer. Your realty agent should emphasize to the seller and listing agent that you've got to buy below the recent sales prices of comparable nearby houses to compensate for the adverse location across from the school.

Lowdown on pricing

Q: My wife and I are in the market for a larger house. A friend who bought a house last year tells me most home sellers overprice their homes by 5 percent to 10 percent above what they expect to get. He also told me home builders also will negotiate on their prices. Is this true or false?

A: Neither true nor false. Let's discuss resale homes first. Presuming a normal market, with no oversupply of home buyers or sellers, there is usually room to negotiate on price as well as personal property, such as appliances, to be included in the sale.

Before making an offer to buy a house, insist your realty agent prepare a written comparative market analysis. This form will show you recent sales prices of nearby comparable homes. It also shows the asking price of similar neighborhood houses listed for sale. After discussing the pros and cons of the recently sold homes, you can arrive at an intelligent offer price for the home you want to buy. Your offer price might be far below an inflated asking price. Or it might be close to an asking price set correctly at market value by a motivated seller.

As for negotiating with builders of new homes, it's a different story. Builders try to hold firm on their asking prices, because a low sales price on one home affects the appraisals on subsequent sales. However, home builders usually will negotiate on the extra features to be included. If new-home sales are slow, however, home builders will negotiate on price and features, especially if they have inventory that costs money to carry unsold.

A good investment

Q: Since the early 1980s, we have tried to buy one rental house every year for investment. We now have 12 houses. Someday we plan to sell them off gradually to provide retirement income by carrying back first or second mortgages. However, our rental houses are in an area that is appreciating only 3 percent or 4 percent annually.

Do you believe it still makes sense to buy rental houses if they appreciate so slowly in market value?

A: Appreciation of 3 percent or 4 percent per year is 30 percent to 40 percent in 10 years. That's very good. But to assure a profit, I recommend investing in fixer-upper houses, which need work and can be purchased substantially below market value.

Look for sound, well-located houses needing cosmetic fix-up such as painting, minor repairs, cleaning, carpeting and landscaping. Avoid houses that need major renovation. These profitable improvements will force the market value of the house up, usually by far more than the cost. My personal goal is to increase the market value by $2 for each $1 spent on improvements. It's called "forced inflation."

Lease-option deal

Q: For about seven months I've been trying to sell my house. It was listed with a real estate agent for six months, with two price reductions. She brought me only one purchase offer, but the buyer couldn't qualify for a mortgage.

The big drawback is that the house needs repairs, and I don't have the money to make them. I've learned there aren't many buyers for fix-up houses. After the listing expired and I began advertising the house "for sale or rent," a young couple offered to lease the house for a year with an option to buy. They want a 100 percent rent credit toward the purchase price. I'm willing to agree, but I don't want them expecting me to pay for any repairs.

Is this reasonable?

A: Yes. Everything is negotiable, especially with a lease-option. In return for your generous 100 percent rent credit, asking the tenants to pay for repairs is not unreasonable.

As a buyer, I've lease-optioned houses where I paid all maintenance, insurance, property taxes and even the mortgage payment. This is called a net, net, net (or triple net) lease, where the landlord receives a net rent each month.

If you expect your tenants to fix up the house during their lease, so they can exercise their purchase option and obtain a mortgage, be sure to specify in the lease-option what minimum work they are to perform. Also, get a substantial upfront, nonrefundable option consideration just in case they don't perform.

When they buy the house, the option money and the rent credit apply toward the purchase price. If they don't buy, you get to keep the option money and the rent credit is forfeited.

Robert Bruss answers real estate questions of general interest. Write to him in care of Tribune Media Services, 435 N. Michigan Ave., Suite 1400, Chicago, Ill. 60611.
COLUMN: REAL ESTATE MAILBAG
LOAD-DATE: September 7, 1997

Evidentiary Exhibit Number 148

Washingtonian

September, 1997

SECTION: CAPITAL GAINS; Pg. 53

LENGTH: 3049 words

HEADLINE: Blockhead Buys a House

BYLINE: By DICK VICTORY; Earlier adventures of Blockhead recounted by senior editor Dick Victory dealt with smoking (June 1994), gardening (April 1996), acquiring a dog (April 1997), and losing hair (June 1997).

HIGHLIGHT:

Almost Everyone Who's Been in Washington for 30 Years Has Made a Killing in Real Estate, Right? Not This Guy.

BODY:

AN ACQUAINTANCE WHO KEEPS A close watch on his first dollar leaned toward Blockhead recently, drove an elbow toward his ribs, and said knowingly: "You've lived here since the 1960s. Bet you've made a killing in real estate."

Blockhead danced away from the elbow, his usual expression of confusion turning into one of contempt. He does not like to linger over his history as a buyer and seller of houses.

However, in the hope that he may be of service as a negative model, Blockhead has decided to offer for review his real-estate record.

And, to give readers a positive model in matters of house-buying, Blockhead has turned to an agent of note -- Marc Fleisher, whose familiarity with the local residential market is reflected in his remarkable sales record. Profitwise, Fleisher spills more every month than Blockhead makes in a year.

WHEN YOU DISCUSS YOUR REAL-ESTATE history, you inevitably discuss your life.

In the early '60s, when Blockhead first came to work in Washington, his financial circumstances were such that he was barely able to avoid having to sleep in his car. He lived in Northwest DC, on 28th Street, in what was commonly called a one-bedroom apartment.

Blockhead's virtually windowless unit may have been called one thing, but it was surely another. "Large packing crate with partitions" is a fair description.

By any name, it defined him: He was a renter. A renter of a miniature apartment that was dark and cold in winter and dark and hot in summer.

Too strapped to buy a house he really admired, too stubborn to use his savings as a down payment on a house he could afford and thus establish a beachhead as a homeowner, he passed the next 2 1/2 years, as a bachelor, in his quarters on 28th Street.

Lately Blockhead has pondered this question: Where would he be now if he had bought into the real-estate market then?

TO GET AN IDEA OF THAT, BLOCKHEAD asks Fleisher, whose 1996 residential sales of $ 37.5 million suggest that his judgment can be trusted, what a shrewd 1961 home purchase here would be worth today.

Fleisher doesn't have to think hard about the question. Earlier this year, he says, he sold a home for more than $ 1 million that had been bought for $ 61,000 in 1961.

The new owners of the home -- in the Burning Tree area of Bethesda -- won't be living there in the immediate future, Fleisher says. They plan renovations that will increase its value to more than $ 2 million.

That's the kind of story that always makes Blockhead hyperventilate.

BY THE END OF HIS FIRST YEAR IN WASHington, Blockhead has all but conceded that his chosen profession, though offering many satisfactions, is never going to allow him access to the upper brackets of home ownership. Location-location-location seems to him much less relevant than vocation-vocation-vocation.

As a consequence, he spends little time as a bachelor investigating the real-estate market. He also is stuck with a young man's conceit that owning a car will make him happier than owning a home.

Does he abandon that conceit when he marries in 1963? Not Blockhead.

His second place of residence in Washington, as a new husband, is another one-bedroom apartment -- this one is sunnier -- on Columbia Pike near Baileys Crossroads.

The Virginia rental experience lasts a year. The workday commute to his job in Southeast DC is so marked by delays, especially at the 14th Street Bridge, that within weeks of moving in, Blockhead vows never to live on the Virginia side of the river after this lease expires.

Often, as he sits locked in traffic behind the wheel of his new, black Ford Futura convertible with the bright-red interior, he tries to console himself with the thought that his car is the best-looking one in a line that stretches as far as the eye can see.

THE NEXT YEAR, 1964, BLOCKHEAD AND wife, stretching their budget past good sense, rent a two-bedroom, two-bath row-house in DC's Burleith neighborhood on T Street a few doors west of 35th.

For the first time but not the last, Blockhead is living on the edge of elegance rather than in it. Georgetown, the real thing, is just a stone's throw away. When people unfamiliar with the city ask him where he lives, he smiles brightly and says, "Georgetown -- where else?"

He might as well be: Playing out the fantasy that he is living in Georgetown, he winds up spending Georgetown money. On rent. On food. On parking tickets.

After two years Blockhead comes to his senses and decides this is the time to buy. But where? Certainly not in Georgetown. No, the in-town experience encourages him to go out of town. Far out.

IN 1966, BLOCKHEAD BUYS A HOUSE ON TWO acres backing up on state parkland in Clarksburg, Maryland. The house is a new one, built on a hill. From the front windows there is a commanding view of miles of rolling pastureland.

He pays $ 22,500, and the house initially seems to be worth every dollar. It's a great house for someone self-employed. But Blockhead is not self-employed, and Clarksburg is 33 miles from his new workplace, near American University.

His judgment clouded by the woodland appeal of the house's setting, Blockhead has convinced himself that he will rarely have anything longer than a 35-minute commute. Sure -- maybe 35 minutes at 3 AM in the draft of an 18-wheeler going 110. But at rush hour? Impossible.

During one storm in Blockhead's first winter there, the snow in his driveway is so high that he can't budge his car for four days.

Blockhead sticks around for three years, selling for $ 25,500 in 1969. He and his wife and young son will miss the bucolic life there but not the remoteness.

Blockhead here pauses to ask Marc Fleisher to cite another success story -- how about a wiser 1966 investment than one in Clarksburg?

Fleisher pulls this gem from his files: Georgetown rowhouse with three bedrooms and two baths. Value in '66: $ 29,000. Value today: $ 425,000.

SOON AFTER HIS 1969 MOVE BLOCKHEAD becomes a bachelor again. He rents a basement-walkout apartment on G Street near his new job in Southeast DC.

As fast as he can have his landlord repair his French doors, they are unrepaired by a criminal population specializing in TV sets and anything else valuable and portable.

Before buying in 1966 in Clarksburg, Blockhead had looked at a very appealing two-story brick house on Massachusetts Avenue whose down payment was $ 1,500 beyond his means.

Driving past it in 1970, Blockhead notes that it is again for sale. He learns that the down payment required is about $ 3,000 beyond his reach. Over the next 20 years he will occasionally see that this house is for sale and will call to determine price. It will always be beyond his means almost exactly in proportion to his original shortfall.

He comes to think of this as the Fifteen-Hundred-Dollar Rule.

BY 1971 A PATTERN IS EMERGING: BLOCKhead's on the move again, married again, and relocating in Maryland again.

The newlyweds, wanting nothing to do with basement living, rent a two-bedroom apartment from which both can easily commute to work. It's on the second floor of a building at the intersection of East-West Highway and 16th Street in Silver Spring.

They rent rather than buy because Mrs. Blockhead has recently relocated from New England and isn't fond enough of Washington to commit to a purchase.

A lucky break for Mr. Blockhead, because within a couple of years Mrs. Blockhead has decided she likes Washington better than she likes Mr. Blockhead. She moves across town into a place of her own.

BLOCKHEAD REMAINS IN SILVER SPRING until 1974, when, with the help of a loan from his second wife, he buys a small row-house in Greenbelt for $ 16,500. It has two bedrooms, one bath, a galley kitchen, and a living/dining room of modest proportions.

It suits him fine, and within a year he even comes to terms with the hectic commute to and from his new job in downtown DC. Blockhead possibly would be in Greenbelt still were it not for his decision to leave for a Miami sabbatical in the fall of 1978.

He sells the Greenbelt house for $ 22,500, a good run-up when measured in percentages but no match for the windfall of acquaintances elsewhere in the area who have begun to make huge profits turning over homes bought only a few years earlier.

Blockhead is falling dangerously behind in the race for real-estate riches. What would have been a smart buy in 1974?

Drawing again on a Georgetown example, Fleisher cites a large detached house across from Dumbarton Oaks. Value in '74: $ 87,000. Value today: $ 1.5 million.

FROM SEPTEMBER 1978 UNTIL THE FOLlowing September, during his sabbatical, Blockhead lives for a song in a Miami garage apartment belonging to relatives.

One afternoon soon after his arrival he helps them shutter their house and his apartment; the weather service has predicted that a hurricane will pass directly over the city early the following morning.

Miamians go to bed expecting the city's features to be rearranged while they sleep, but the hurricane veers and misses.

The Miami real-estate market is enjoying a boom, but Blockhead has managed to sit it out. The hurricane that fails to show up is the most interesting thing that happens to him on his Florida sabbatical.

BLOCKHEAD RETURNS TO WASHINGTON IN the fall of 1979. From October through December he is put up in the guest bedroom of indulgent friends in Bethesda.

Buying a house is out of the question; Blockhead is jobless. He also can be said to be desperate. How else to explain why, in January of 1980, he agrees to pay a couple of hundred dollars a month to live as a kind of caretaker in a rundown, unheated guest house on a large horse farm in Frederick County?

Blockhead soon begins to generate a little income from a part-time job in Washington, where everybody he talks to seems to be cleaning up in real estate.

Over the next four months, during one of the coldest winters in local memory, and as his weight falls from 180 to 147 pounds, Blockhead chops firewood virtually without pause by day to provide the fuel to keep his fireplace going at night.

He looks after the farm's two dogs while the owners take frequent trips to show their horses. After a month or so he begins to talk to the dogs on long walks around the upper pond and across rock-hard meadows.

The German shepherd tolerates his monologues but ignores him. The other dog -- the one from the breed with a man's name, Jack Russell -- barks on cue and seems to sympathize with whatever it is that his oddly agitated companion is trying to say.

Occasionally a train can be heard clacking by in the distance, its wheels sending out a message Blockhead takes to be meant for him:

You'll-never-learn, you'll-never-learn, you'll-never-learn.

IN AUGUST OF 1980, BLOCKHEAD MOVES back into Washington and goes to work full time with his former employer in downtown DC. He welcomes his son from his first marriage, who will be attending Bethesda-Chevy Chase High School, into a house he's renting on Brookville Road.

Blockhead again finds himself on the edge of elegance -- the elegance of the most venerable section of Chevy Chase, with its wide, quiet streets and spacious, well-kept homes, for which his little frame contemporary will never be mistaken.

Blockhead lives there with his son until early 1982, when Florida beckons again and he decides to take a job in Orlando.

Sick of renting and now able to afford a place of his own, Blockhead buys quickly. What he doesn't know is that there is a good Orlando and an evil Orlando.

HE KNOWS TODAY THAT HE SHOULD HAVE rented while getting the lay of the land. But in '82, having rented for so many of the previous years, he is eager to buy.

In addition, there are the tax advantages and a conviction that he's in Florida for the duration. So why not buy now rather than a year or so later, when prices will, he assumes, be higher?

In the good Orlando, a colleague -- also relocating from Washington -- buys wisely the same year that Blockhead arrives. The colleague acquires a house in the stately suburb called Winter Park for $ 105,000; he will sell it two years later for $ 130,000.

Blockhead buys in the evil Orlando, paying $ 82,500 for a four-bedroom house with two baths, two-car garage, large screened porch, and a fenced backyard featuring pool, garden, and mature orange trees.

Some may ask: What's so evil about that? Compared with houses of its size then available on the Washington market, his house would seem to be a good buy. Moreover, it isn't fair to blame the demands of Blockhead's mortgage, with its interest rate of 15 percent, on Orlando.

Here's the evil part: When hurriedly buying, Blockhead is buying on the wrong side of the tracks. He is buying to the east of Semoran Boulevard, territory that smart money avoids. To the west of Semoran is the Orlando suburb of Winter Park, a place of beautiful stucco homes where prices steadily rise.

Blockhead's real-estate mistake is a persistent cause of embarrassment, and over the next couple of years he also finds himself growing disillusioned with Florida, a strange place to get used to.

He enjoys his work and his colleagues but comes to think that Florida's general population is as strange as the state's lower life forms -- its bold tarantulas and mighty roaches, its strolling catfish and concrete-devouring termites, its aptly named fire ants and all their exotic peers.

In Florida, when you get up in the morning and go to slip foot into shoe, you never know what your toes will find.

Returning from work one summer evening, Blockhead discovers a pygmy rattlesnake in his mailbox. Is nature or a neighbor trying to tell him something? It doesn't matter. He's had enough.

He puts his house on the market in the early spring of 1985 and heads back to Washington. Twelve months after the house is put up for sale, Blockhead's Orlando agent finally lands a buyer.

Four years after being sold to Blockhead for $ 82,500, the house brings $ 84,000. After fees, he takes a loss.

Blockhead puts this question to Marc Fleisher: What if he had remained in Washington and bought thoughtfully in 1982?

The agent cites a house in DC's Friendship Heights with four bedrooms and 2 1/2 baths. Value in '82:$ 112,500. Value today: $ 250,000 (down from a peak of $ 320,000 a few years ago).

IN 1985, BLOCKHEAD, NOW REMARRIED, moves into a two-bedroom rental apartment near the Grosvenor Metro stop.

While there, Mr. and Mrs. Blockhead investigate an opportunity to buy a lovely Tudor in Chevy Chase. On a Tuesday they receive a tip about its availability from a friend whose mother is a contemporary of the elderly woman preparing to list the house with an agent the following Friday. She's entertaining offers before then.

Blockhead and wife are the first potential buyers to see the Tudor, priced at $ 160,000, a remarkable bargain for a three-bedroom house with 1 1/2 baths, large living and dining rooms, unfinished attic, high-ceilinged basement, and enough lawn to accommodate an addition. A friend familiar with neighborhood prices says the house is easily worth $ 250,000.

Blockhead likes the house but, remembering how he misjudged the Clarksburg commute, insists that the Tudor must prove to be within 30 minutes, via public transportation, of his DC office.

The next morning he drives to the house, parks, and walks to a Ride-On stop about two blocks away. He has to wait there 40 minutes past the bus's scheduled appearance before it arrives to take him to the Friendship Heights Metro station.

By then trains are running on an off-rush-hour schedule, and his trip to work takes an hour and five minutes.

So Blockhead kisses off the Tudor in a neighborhood where today homes of roughly its size routinely sell for $ 450,000. Blockhead's friends call his Ride-On brainstorm the $ 300,000 bus ride.

IN 1987 MR. AND MRS. BLOCKHEAD MOVE from the apartment near the Grosvenor station. For $ 161,000 they buy a pretty bungalow on a little-traveled street in Kensington. They want a child-friendly environment for the addition they're expecting early the following year.

The house dates from the 1920s, an era when most Americans were smaller people. Blockhead often scrapes the top of his head on the low ceiling of the stairway to the basement.

There also is the matter of the bamboo. In the backyard there's a stand of it more difficult to remove than a land mine, a device that pops into Blockhead's mind every time his glance falls on the bamboo.

Yet, despite shortcomings, it's a wonderful house in a neighborhood with an abundance of nice people, and the Blockhead family, which adds a son in 1988, spends seven fine years there.

But Blockhead is not a man to leave well enough alone. In 1994, after months of cajoling, he convinces his wife that they need larger quarters. That fall they sell the old Kensington house for $ 220,000 and buy a contemporary in Bethesda.

Blockhead is wearing a smug smile.

Fleisher knocks the smile off his face by citing a center-hall Colonial on two acres in the zone where Bethesda merges with Potomac. Value new in '87: $ 395,000. Value today: $ 800,000.

THE BLOCKHEADS, WHO SPENT IN BETHESda more than twice what they did to buy in Kensington, still live in the contemporary they bought in '94.

Although Blockhead's vocation remains the same, one that will never bring riches, he now often reassures himself that he has finally acted sensibly when it comes to recognizing the value of location.

After all, his Bethesda home, which cost about $ 40,000 when new in 1963, is now worth more than $ 400,000, and the appeal of his model -- with its four bedrooms, three baths, den, two-car garage, and separate office, among other features -- suggests that its value will continue to appreciate.

Nonetheless, Blockhead isn't sanguine about a great windfall down the road. He remembers the past too vividly.

Sometimes, late at night, as he looks out the large picture windows of his handsome brick house nestled on a knoll among tall poplars and white pines, he imagines he hears the mournful echo of the distant train that spoke to him years earlier in Frederick County. Its message is the same as before.

Will he ever learn?

GRAPHIC: Photograph, Blockhead has owned three homes in Maryland -- in Clarksburg, then in Greenbelt, and now in Bethesda. His current property, shown here, may be his first sound investment. BY RON BLUNT

LOAD-DATE: September 29, 1997

Evidentiary Exhibit Number 149

Orlando Sentinel (Florida)
August 17, 1997 Sunday, METRO

SECTION: HOMES; Pg. J5
LENGTH: 1015 words

HEADLINE: CHECK WITH FANNIE MAE FOR SPECIAL HOME LOAN PROGRAM

BYLINE: Robert Bruss,Tribune Media Services

BODY:

QUESTION: My wife and I want to buy a modest house for our family. We don't speak or write English very well (although we have become U.S. citizens during the past year). So we relied on our realty agent to help us.

She found a home we liked and prepared our purchase offer. We made a $2,500 earnest money deposit with our offer. The seller accepted. But our realty agent can't find us a mortgage. I am a gardener, and the mortgage companies don't believe I earn enough to make mortgage payments. However, for the past eight years we have paid more monthly rent than our mortgage payment will cost us.

Also, we have enough for a 10 percent down payment. Our seller is angry at us because we can't get a mortgage. I don't blame her. Can we at least get our $2,500 back?

ANSWER: You are the type of home buyer Fannie Mae and other major mortgage lenders want for their special home loan programs. I am surprised your realty agent couldn't arrange a mortgage using alternative verifications, such as rent receipts and utility payments. To get in touch with a local Fannie Mae mortgage lender, call 1-800-732-6643. One way or another, you can finance that home purchase.

Tax on refinance money?

Q: Our home is worth about $220,000. The mortgage is paid down to around $87,000. We want to refinance to reduce our interest rate and get some cash so we can add a family room, but a friend told us we will owe tax on the money we receive. Is this true?

A: No. Your friend is mistaken. Mortgage refinance money is not taxable. There is a good reason; you must pay it back. It would hardly be fair to tax you on money that must be repaid.

Deduction for rental house

Q: You have said to a homeowner that if she decides to rent her house to tenants, instead of selling it, she can take an income tax deduction for depreciation. I've never heard of that tax deduction. What is depreciation?

A: Depreciation is a noncash bookkeeping tax deduction for estimated wear, tear and obsolescence on business and rental properties. Residential rental property must be depreciated over 27.5 years on a straight-line basis.

That means the property owner divides the adjusted cost basis of the building by 27.5, not including land value, which is not depreciable, and deducts that amount each year as if it were a cash expense.

Depreciation is the best income tax deduction there is, because it doesn't require any cash payment, such as mortgage interest, fire insurance and property taxes.

Developer dominates condo

Q: I am considering buying a two-bedroom condo in a 5-year-old, nine-unit, well-maintained, luxury condo building in a great location. The asking price is reasonable. Houses in the vicinity sell for much more.

My problem is that the developer lives in the penthouse condo and owns four of the condos, which he rents to tenants. He says he plans to sell at least one of his condos in the next year. I would be buying from another owner. I've found a mortgage lender, though not without difficulty because so many of the units are rentals. I'm concerned when I resell, perhaps in five years, my buyer also might have difficulty getting a mortgage if there are still so many rentals.

Would you buy in a situation like this?

A: There is no right or wrong answer to your question. Your biggest potential problem is that the developer still owns a majority of the condos and therefore controls the homeowners association. If he should default in his monthly maintenance payments, the association would be in serious trouble.

Condo owners are part of a minidemocracy, but in your situation it could be a dictatorship. I suggest you talk with the other owners, as well as the developer, to get a feel for whether it's worth taking a chance. Ask the owners what they like best and least about their condo and whether they would buy a condo there again.

Also, check the financial condition of the association to be sure its reserves are adequate. Be sure to test the soundproofing, because noise transmission between condo units is the No. 1 condo owner's complaint.

Dumping unwanted lot

Q: I have a lot in a Florida subdivision where only about 10 percent of the lots have houses on them. It's like a ghost town. I don't want to build on my lot since my husband died. But local agents tell me there are no lot buyers. Each year I have to pay the property taxes. If I quit paying, since I live out of state, will this be the end of my problem? Will my unpaid property taxes show up on my credit report?

A: If you don't pay your property taxes, the county eventually will sell your lot for the unpaid taxes. This is the best way to abandon your property.

A few years ago, I had trouble with unpaid property taxes on a property I sold. The delinquency showed up on my credit report, but I finally got it removed. I can't guarantee that won't happen to you, but if it does, you can probably get it removed by explaining your good reason for nonpayment.

Lowdown on living trusts

Q: My son recommends I put my house, car, savings and checking accounts, stocks and bonds, and a vacation home into a living trust. He says this is better than a will because, if I become disabled, a conservator doesn't have to be appointed by the court to manage my affairs. Also, he says a living trust saves probate costs.

What do you think about these new living trusts?

A: Living trusts have been around many years. I believe you have a very smart son. He knows a living trust is the best way for people to hold title to their major assets.

In addition to saving probate costs and delays, a living trust provides for a conservator if you should become unable to manage your affairs.

While you are alive and in good health, you continue to manage your living trust assets just as before. You can buy and sell as if they were not in a living trust. For further details, consult an attorney who specializes in living trusts.

Robert Bruss answers real estate questions of general interest. Write to him in care of Tribune Media Services, 435 N. Michigan Ave., Suite 1400, Chicago, Ill. 60611.

COLUMN: REAL ESTATE MAILBAG

LOAD-DATE: August 17, 1997

Evidentiary Exhibit Number 150

Crain's Chicago Business

August 11, 1997

SECTION: News; Pg. 3

LENGTH: 788 words

HEADLINE: NEW CONSTRUCTION IN DOWNTOWN MARKET? WACKER TOWERS' PRICE COULD TRIGGER NEW DEVELOPMENT ROUND

BYLINE: THOMAS A. CORFMAN

BODY:

The $500 million that Chicago investor Sam Zell is about to pay for the twin-towered office complex at 10 and 30 S. Wacker Drive has developers smiling and builders oiling their cranes in anticipation of new downtown construction.

The reason: The price being paid by Mr. Zell's publicly traded Equity Office Properties Trust is equal to $250 per square foot. That's comparable to the cost of new construction -- leading many to think the downtown office market is ripe for fresh development.

Real estate sources confirmed last week that Equity had signed a letter of intent with owner's agent Nomura Securities Co. of Tokyo for the two 40-story buildings that adjoin the trading floors of the Chicago Mercantile Exchange.

The transaction is the latest in a series of high-priced downtown office sales fueled by cash-rich real estate investment trusts (REITs) like Equity.

"New construction is just around the corner," predicts Steven Fifield, president and CEO of Fifield Cos., which owns a half-acre vacant lot at 201 W. Madison St.

Adds Gene Ventura, vice-president of Development Resources LLC, which last month announced plans to build a 17-story office building at 550 W. Van Buren St.: "At $250 per square foot, you're right at replacement costs. That's a big benchmark."

And while the 2-million-square-foot Merc office complex is a desirable property, the price was pushed up by a scenario that will become commonplace: REITs are loaded with cash, eager to invest and convinced that downtown office rents will rise.

Many expect office REITs to continue to bid up the price of downtown office buildings as they have done in the suburbs.

Among those making offers for the Merc complex was Boston-based Beacon Properties Corp., a REIT that in May bought the five-building Westbrook Corporate Center in Westchester.

Other bidders: Chicago-based Prime Group Inc. and Toronto-based Trizec-Hahn Corp. Losing bids for the buildings ranged from $240 to $220 per square foot, sources say.

Yet as building prices increase, buyers may be hard-pressed to increase returns.

"At $250 a square foot, to achieve a return of 5% you need net rents of about $12 (a square foot)," says Jacque Ducharme, head of the Chicago office of New York-based Julien J. Studley & Co. "That's easy to get in the marketplace."

But "to raise your return above 10% you need to get $25 per square foot," he says. "That's going to be harder to get right now."

An attractive tenant

Once the sale is complete, the Merc Towers will bring to five the number of Chicago buildings owned by Zell's REIT. In 1992, Zell paid $71 per square foot for the brand-new, near-empty 1 N. Franklin St., a 37-story building. In 1995, he got another bargain, paying $118 per square foot for the 50-story 161 N. Clark St.

Zell's newest acquisition is so attractive because of the trading floors, which are sandwiched between the two towers. The middle building, which is owned by the Merc, is not affected by the sale.

Yet exchange members rent about 280,000 square feet, and they are willing to pay premium rents to be close to the trading floors.

"Whenever you look at a building, you look at the tenants, and the Mercantile Exchange enhances the value of these buildings," says Bob Winter, president and CEO of Amli Commercial Properties LLC, a private investment fund that owns Chicago-area industrial and office buildings.

Aside from Zell's vulture buys, there was little activity in the Class A downtown office market until December 1995.

Equity Office is paying about 15% more than was paid for the AT&T Corporate Center at 227 W. Monroe St., which had held the price record.

A strict price comparison is not possible because so much of a building's value depends on its rent roll -- its list of tenants, rents and length of leases.

Buildings whose tenants have shorter leases will fetch higher prices because the new owners will be able to take quicker advantage of increasing rents.

A good time to sell

Even so, recent sales show that the market is gaining momentum:

* Singapore Government Investment Corp. paid $545 million, or $218 per square foot, for the AT&T Corporate Center and an adjacent USG Corp. building.

* In October 1996, German industrialist Hugo Mann paid about $200 per square foot for the NBC Tower when his Delray Beach, Fla.-based Sunbelt Management bought the building and adjacent property from Atlanta-based Equitable Real Estate Management Inc.

* Atlanta-based Overseas Partners Capital Corp. paid $109 million, or $132 per square foot, in December for the curved-glass 333 W. Wacker building.

"In today's market, it's a pretty good time to sell," says Mr. Winter.
GRAPHIC: Buy and Zell: Sam Zell paid $250 a square foot for these towers; developers may decide that makes building from the ground up worthwhile again.
LOAD-DATE: August 14, 1997

Evidentiary Exhibit Number 151

Chicago Tribune
June 20, 1997 Friday, DU PAGE SPORTS FINAL EDITION
SECTION: YOUR PLACE; Pg. 31; ZONE: D; Renting. Where to look. How to bargain.
LENGTH: 1604 words

HEADLINE: TAKING IN TENANTS;
CAN'T SELL YOUR HOUSE? DON'T WANT TO? TRY THE RENTAL OPTION

BYLINE: By Marilyn Kennedy Melia. Special to the Tribune.

BODY:

When Rev. Judy Chatfield was offered a position as a pastor at a church in LaSalle, Ill., the opportunity was tempting enough to persuade her to move from her Hinsdale home. But although Judy and her husband, Don, also a minister, made the move, they decided not to pull up stakes entirely and sell their home.

"It was our first home together. We lived in it about seven years, and it's very dear to us," explains Judy.

Like the Chatfields, many homeowners decide to call the moving van without signing a sales contract. Sometimes it's an emotional attachment that prompts them to retain the property. Some homeowners know a move is only temporary, and that they'll be moving back within a year or two. And, some owners are forced to maintain ownership if they've been unsuccessful selling the property, and they have already purchased another home.

No matter what the reason for their move, owners in these situations often decide to rent their home out during their absence. The landlord role, however, is fraught with paperwork, tax consequences and possibly nasty tangles with tenants.

In fact, homeowners who are forced into renting because they can't sell may want to consider other options. "A home usually doesn't sell because of a problem with its location, condition, or price," notes Mary Ann Sullivan, an agent with John Greene Realty in Naperville. "If you really want to sell, you have to assess honestly why the home hasn't moved. In many cases, you're better off taking a lower price and selling rather than trying to rent to cover the extra expenses of two mortgages and a bridge loan.

"And if you do rent, you have to give consideration to how the home will show during the rental period, and the condition it will be left in. I usually advocate renting only if there is a market condition that is inhibiting your sale--for instance if your home is an early resale in a brand new subdivision."

However, if you do become a landlord for whatever reason, do so with your eyes open to all of the responsibilities involved with collecting a monthly rent check.

Depending on their motivation for renting, homeowners will have to heed various IRS rules.

For instance, if you're renting because of an unsuccessful sales attempt, you'll still be under the gun to sell your home within two years. That's the time frame that the IRS allows you to reinvest profits from a sale of your principal residence into a new home of equal or greater value, notes Mark Luscombe, a lawyer and CPA at CCH Inc., a tax information publisher based in Riverwoods.

This means that if you've purchased a home, but haven't yet sold your previous residence, you won't be taxed on any profits from the sale of that home, as long as you sell within two years of the purchase, and count the profits as going towards the purchase of the new home.

In order to ensure that the IRS doesn't try to claim a portion of the profits from the sale, owners should not only heed the two-year time frame, warns Luscombe, but should also exhibit a good faith effort to sell during the rental period. Otherwise, the IRS might rule that your real intent was to establish a rental business and then you wouldn't be able to re-invest profits.

"The way the law has developed," explains Luscombe, "is that if the rental is necessitated by your inability to sell or because it wouldn't be wise to sell because of poor market conditions, then you can still treat the home as a residence for rollover (of profits)."

If homeowners include a provision in their lease that permits them to continue to list the home for sale, and show it to prospective buyers, says Luscombe, that helps bolster their position with the IRS that they are serious about selling.

Owners forced into renting because their company transfers them, adds Luscombe, would still be able to roll over profits on the eventual sale of their home if they return within a year or two, because the home would still remain their principal residence during a short absence. It helps to leave behind some possessions--some furniture, for example--to show your sincere intent to return, Luscombe suggests.

What's the rent?

How much should you ask in rent? "Just enough to cover my mortgage," many harried homeowners footing the bills on two homes will be tempted to respond.

You'll have to remember, however, that a renter doesn't give a hoot about your expenses. He'll be comparing your price to what similar houses in the area are renting for.

The best way to set the rent is to consider both your expenses and what the market will bear. "We want to find out what it's going to take to make it (the rental) work for the owner," explains Carolyn Ridge, listing director with The Apartment People, Chicago. "And we also consider information about the market and what the individual home has to offer."

Real estate agents say a formula has been in place that translates a home's sales value into a monthly rental charge. Specifically, 1 percent of the value translates into rent. A $300,000 home, for instance, would carry a $3,000 rent.

That formula, however, was firmer when mortgage interest rates were higher several years ago. Now, notes Cheri Turnquist, agent with Rental Homes Inc., Naperville, many homes rent for 1 percent of the mortgage amount, figuring a mortgage to be 80 percent of the total value.

Choosing a tenant

Whatever the rent charged, you'll want the tenant to pay it--and on time. Selecting a tenant who's reliable and respectful of the property is key to a successful rental experience.

A tenant shouldn't have any trouble paying his rent if his gross, or before-tax, income is three to four times the amount of the rent, says Ridge. You can ask a prospective tenant to submit pay stubs to verify his or her income, suggests Robert Boron, a Chicago attorney who specializes in rental issues and who also writes the Rental Q&A column in Your Place.

You can check out whether a prospective tenant is in the habit of paying his bills on time if you ask him to supply you with a copy of his credit report. Although professional landlords usually hire a service to provide them with credit reports, the cost and legalities involved for an individual homeowner to do such snooping make

it more practical simply to ask the tenant to obtain his own report, says Gene Sherman of Computerized Information Service Inc., Northbrook. Individuals can obtain a copy of their own report from services such as Equifax (800-685-1111) or Experian (800-682-7654).

You can refuse a tenant, notes Boron, if he refuses to submit a copy of his credit report, or if his credit is marred. You can also refuse if his income falls short of being three times the rent. When a tenant does pass muster, you'll then want to ask for a month or a month and a half of rent upfront as a security deposit. Wait until the check clears before allowing the tenant to move in.

Needless to say, investigating tenants and negotiating a lease may not be palatable to owners with pushover tendencies. You can hire a realty firm or apartment finder service to do the legwork for you. "An owner need get involved only as much as he chooses to," says Ridge of The Apartment People. "We will negotiate the lease, add riders to the lease according to the owner's request, and supply credit and employment checks."

Although you can hire help for lease negotiations, it's difficult to find firms willing to collect the rent and provide management services. Rental Homes Inc. of Naperville charges 10 percent of the monthly rental as a management fee, fielding tenant calls about repairs, supervising the lawn maintenance, etc. Many apartment management firms, however, will not take on an individual unit.

In many cases, though, out-of-town homeowners can enlist the help of a trusted friend, or even a real estate agent, notes Nancy Whitehurst of Baird & Warner, Hinsdale. "Realtors might do this as a favor," in order to build good will and garner future business.

Look at the lease

While screening tenants is important, a good lease cements good landlord-tenant relations. Especially if you are doing the lease negotiations yourself, and have purchased a standard lease form from an office supply store, you'll want to take the lease to an attorney to ensure that you're in compliance with any local landlord-tenant ordinances.

Certain provisions must also be clearly underscored in the lease agreement, notes Boron. "Who is going to make repairs on what has to be very clearly defined. If you have a large apartment building, and there is a problem with the heating or plumbing, there's no question that the landlord must make the repair. But in a home, where there is only one tenant, some landlords may feel the tenant is responsible."

Whitehurst of Baird & Warner says that she often sees tenants being responsible for appliance repairs, "but not very often are they responsible for problems with basic operating systems." She illustrates: "Certainly if something gets caught in the drain, it could be the tenant's fault and his responsibility, but if roots grow around the plumbing line, that is the responsibility of the homeowner."

Insurance issues involving the safety and condition of the property must also be clearly spelled out, as well as any possible provisions about the home being kept on the sale market, says Boron.

Although renting is a business venture, it can also be satisfying knowing that a home you love is still in your hands. Says Rev. Judy Chatfield: "We may return to our home someday. And in the meantime, we know that the house is being maintained well."

GRAPHIC: PHOTOPHOTO: Nancy Whitehurst of Baird & Warner in Hinsdale says a real estate agent might agree to collect the rent on your house as a favor to build good will and garner future business. Photo for the Tribune by Mike Fisher.

LOAD-DATE: June 20, 1997

Evidentiary Exhibit Number 152

Chicago Tribune

May 31, 1997 Saturday, WEST COOK SPORTS FINAL EDITION

SECTION: NEW HOMES; Pg. 32; ZONE: W; Realty Q&A.

LENGTH: 937 words

HEADLINE: OFFER SHOPPING;

BUYERS SHOULD PUT A TIME LIMIT ON A PURCHASE BID

BYLINE: By Robert J. Bruss, Tribune Media Services.

BODY:

Q--We recently lost out on the purchase of a home to another buyer who offered slightly more than we did. Our agent is my nephew and I'm trying to help him get started in realty sales.

He wrote in our purchase bid it was good for a week. After he delivered our offer to the seller, he reported to us the seller wanted to think it over for a few days. I thought we should have gotten an immediate "yes" or "no." Is this procedure customary?

A--No. Home purchase offers are usually valid for 24 hours, unless there is an unusual situation such as an out-of-town seller who doesn't have access to a fax machine or telephone.

Your nephew made a very bad mistake by making your offer valid for a week. That gave the seller's listing agent time to "shop" your offer to get a higher offer from another buyer. In the future, provide for a 24-hour offer expiration time to prevent "offer shopping."

Q--I've owned an apartment building about 30 years and it is fully depreciated. Is there any way I can start over on the depreciation?

A--No. If you sell your building, you will have a tremendous capital gains tax to pay (even if Congress reduces the capital gains tax rate).

A better alternative is to make a tax-deferred exchange of your apartment building for another "like kind" investment or business property, such as apartments, offices or stores. As long as you trade up in value and equity, but don't take out any taxable "boot" such as cash or net mortgage relief, you can avoid tax and then start depreciating your new building.

More details are in my report "How to Profit from Starker Tax-Deferred Exchanges" available for $4 from Robert Bruss, 251 Park Rd., Burlingame, Calif. 94010.

Q--We are in the process of refinancing our home mortgage. The lender asked if we wanted an escrow impound account for the property taxes and fire insurance. I thought that was required. We had one with our last mortgage.

Do you think we should have an escrow account with our mortgage?

A--VA, FHA and PMI (private mortgage insurance) home loans require escrow impound accounts for property taxes and fire insurance. Each month one 12th of the estimated bills is collected along with your principal and interest mortgage payment. When these bills come due, the loan servicer pays them.

I do not recommend an escrow impound account unless you're required to have one, because loan servicers often over-collect, even though federal regulations now limit such collections. If the loan servicer under-collects, then the borrower frequently receives a threatening letter demanding immediate full payment of the deficit.

I have one mortgage with an escrow impound account and the lender is constantly over- or under-collecting payments. My preference is to pay the insurance and taxes myself.

Q--Next month, I'll be renting an apartment. I'm starting a new job and moving to a new location, so I don't want to rush to buy a house or condo. The nicer apartments I've inspected require a one-year lease, but some of the others offer a choice of one-year lease or month-to-month rental.

Which is best for me?

A--A one-year lease protects you from any rent raises during that year. But it also obligates you to stay for at least 12 months. If you should decide to move out, breaking the lease could be expensive.

With a month-to-month rental agreement, the landlord could raise the rent or ask you to move out (in the absence of any local rent control or other rental ordinances). Chances of a landlord raising the rent in less than one year are slim, however, except in cities with a shortage of rentals.

There is no right or wrong answer to your question. But unless you are 100 percent certain you will like the apartment and want to stay at least 12 months, your best bet may be the month-to-month rental. It gives you the freedom to move out if you don't like the apartment or decide to buy a home.

Q--We're just starting to think about selling our home. The only Realtor we know is the one who sold us our home about six years ago. She charges a 6 percent sales commission. Could we save on the commission by listing with another Realtor or are commissions set by law?

A--Real estate sales commissions are negotiable between the realty agent and the home seller. But most agents charge 6 or 7 percent of the home's gross sales price.

Yes, you will find some realty agents who charge a lower sales commission than the "going rate" in the community. But these agents find it difficult to interest other agents in showing a home with a lower-than-normal sales commission.

If you want to get your home sold quickly, I suggest you agree to pay the customary commission rate and be certain your listing is immediately put in the local multiple listing service to give it maximum exposure to the marketplace.

Q--My wife and I are buying our first home. We have one child, age 14. A friend suggests we include her name on our deed in case anything happens to my wife and me, such as a car crash. Is this a good idea?

A--No. Minors can hold title to real estate but they cannot convey title if you should decide to sell before your daughter becomes 18.

In the event of such a sale, a court-appointed guardian would be required to represent her. Keep minors off real estate titles--that's my best advice. A real estate attorney can explain further.

PLEASE NOTE: Real estate laws vary from place to place. Be sure to check the laws of your state and municipality before making decisions on real estate matters.

Write to Robert Bruss at Tribune Media Services, 435 N. Michigan Ave., Chicago, Ill. 60611.

LOAD-DATE: May 31, 1997

Evidentiary Exhibit Number 153

Chicago Tribune

May 3, 1997 Saturday, WEST COOK SPORTS FINAL EDITION

SECTION: NEW HOMES; Pg. 36; ZONE: W; Realty Q&A.

LENGTH: 1336 words

HEADLINE: KEEPING YOUR PROFITS;
HOME SELLERS HAVE THREE BASIC WAYS TO AVOID TAXES

BYLINE: By Robert J. Bruss, Tribune Media Services.

BODY:

Q--My wife and I are discussing selling our large home, which is getting too expensive and time-consuming to maintain. I'm 74 and she's 72. Our main concern is taxes on our profit of close to $200,000. We're not counting on President Clinton's tax abatement getting through Congress this year.

Other than that $125,000 "old folks" tax exemption, is there any way we can avoid tax if we sell our home?

A--Yes. I agree there is no guarantee Congress will pass the proposed $250,000 per person ($500,000 per couple) home sale tax exemption. Currently, there are three basic ways principal residence sellers can avoid tax on their sale profits:

1. The "over 55 rule" $125,000 home sale tax exemption. Since you and your spouse are well over 55, presuming you haven't used this tax break before and have owned and lived in your principal residence at least three of the five years before its sale, up to $125,000 of your sale profit will be tax exempt.

2. The rollover residence replacement rule. This tax deferral rule applies to home sellers of any age. They must defer their profit tax if they sell their principal residence and buy a replacement home of equal or greater cost within 24 months before or after the sale.

You can combine this tax rule with the $125,000 exemption to shelter all your profit from tax. For example, suppose your home sells for a net price of $300,000 after sales expenses. Subtracting the $125,000 "over 55 rule" exemption leaves a $175,000 "revised adjusted sales price." Just buy a replacement home costing at least $175,000 in this example to exempt $125,000 of your sale profit from tax and defer tax on the $75,000 profit.

3. Installment sale. You can use the "over 55 rule" $125,000 exemption and spread out tax on the remainder of your profit by making an installment sale. This means you must carry back a first or second mortgage for your home buyer. An added advantage is a quick, easy sale for top dollar, since you offer easy financing.

Ask your tax adviser to explain further about these three home sale tax avoidance methods.

Q--I have my eye on buying some rural acreage for future development. The parcel that interests me is 46 acres. It has been for sale several years at a very reasonable price.

I talked with my banker about a 75 percent mortgage loan, but he says banks don't like mortgages on vacant land. I got the same answer from four other banks. How can I finance my investment in this potentially valuable land?

A--Financing the purchase of vacant land is virtually impossible, unless you're an experienced developer with a success record. Mortgage lenders know the default rate on land is very high. Reselling land after foreclosure is extremely difficult.

Virtually the only way to finance land purchases is for the seller to carry back the mortgage for at least 10 years. By then you should be able to develop the land. If the seller won't finance your purchase, maybe you shouldn't buy.

Please remember my frequent advice to avoid buying real estate you won't use within six months of purchase.

Q--The apartment building where I live was recently sold. Should I be concerned about my $550 security deposit? The new owner hasn't said anything to the 22 tenants about our deposits. Should we do anything to get credit for our deposits?

A--Yes. To prevent errors and misunderstandings, immediately after an apartment building sale is an excellent time to verify your security deposit with the new owner.

When you pay your rent, attach a short letter asking the new owner to verify in writing that your $550 security deposit was transferred. Usually, the tenants are asked to sign estoppel letters confirming the terms of their lease and the security deposit. Since this apparently wasn't done, you should verify your deposit now to prevent a future problem.

Q--I want to sell my home and exchange it for a small apartment building. But my CPA has never heard of a Starker tax-deferred exchange for a simple situation like this. He says it can't be done.

Where can I find someone who can show me how to do a Starker exchange?

A--I am shocked your CPA has never heard of a Starker delayed tax-deferred exchange. He or she should read Internal Revenue Code 1031(a)(3).

However, it doesn't apply to your situation because your personal residence is not eligible. Starker delayed exchanges are only available for property held for investment or use in a trade or business.

But you can make your home comply by moving out and renting it to tenants. It then becomes investment or business property, eligible for a tax-deferred exchange. Then you can sell it, have the sales proceeds held beyond your constructive receipt by a third-party intermediary such as a bank trust department, and use those proceeds to acquire the apartment building you want.

After the rental home sale closes, you have 45 days to designate the investment or business property you want, and 180 days to complete the acquisition. I'm sending you my report "How to Profit from Starker Tax-Deferred Exchanges." Readers can obtain a copy for $4 sent to Robert Bruss, 251 Park Road, Burlingame, Calif. 94010.

Q--My mother is dying. She wants to give her her house. But I recall your saying it's better to inherit property than receive it as a gift. Why?

A--When you inherit real estate, you receive it with a cost basis of its market value on the date of the decedent's death. If you receive it as a gift, you take over the donor's usually much lower adjusted cost basis.

The higher your cost basis, the better. To illustrate, suppose your mother's cost basis for her home is $25,000, but it is worth $100,000 when she dies. If you inherit the house and sell it for $100,000, you owe no capital gain tax since you have no profit. But if you receive that house as a gift while your mother is alive, you take over her $25,000 cost basis. Should you decide to sell it for $100,000, you'll have a $75,000 taxable capital gain. Ask your tax adviser to explain further.

To avoid probate, ask your mother to put title to her house and other major assets into a living trust. While she is alive she can still manage her assets normally. But when she dies, under the terms of the living trust, the assets can go to you without probate costs or delays. An attorney can usually set up a living trust for $500 to $1,000 unless it is very complicated.

Q--I recently got an unexpected job offer outside the United States. At the same time, my newly purchased home is about ready to close. I am thinking about selling the house or renting it to tenants.

Is it a good idea to lease the house rather than selling it? If I rent, how can I find a reliable realty agent to rent and manage it? How much rent should I charge? Who will pay the mortgage?

A--I presume you've decided to accept the foreign job offer. Selling your newly purchased home could be a costly mistake. It will cost at least a 6 percent sales commission, plus other sales expenses.

Of course, if you don't plan to return to the area, ask if you can pay the seller a few thousand dollars to cancel your purchase. That might be a very wise expenditure.

Although I do not recommend long-distance home rentals, if you go through with the purchase you don't have any viable alternative. While you're renting the house, at least you'll get some tax shelter from depreciation tax deduction.

Many larger residential real estate sales offices have rental departments, which will find you a reliable tenant and collect the monthly rent. If you wish, they can pay the mortgage from the rent collected. However, you'll be better off paying the mortgage yourself, so you're sure it gets paid on time.

By the way, the mortgage lender might give you a little trouble if you are discovered not to be living in the house. Presumably, you have an owner-occupant loan at the best loan terms. If asked, just explain you received an unexpected out-of-town job offer, but you plan to return to live in the house (if you do).
LOAD-DATE: May 3, 1997

Evidentiary Exhibit Number 154

Orlando Sentinel (Florida)

April 27, 1997 Sunday, METRO

SECTION: HOMES; Pg. J6

LENGTH: 1150 words

HEADLINE: NO DOWN PAYMENT? LOAN BROKER CAN HELP YOU FIND A WAY TO BUY

BYLINE: Robert Bruss,Tribune Media Services

BODY:

QUESTION: A few years ago I recall advertisements for real estate seminars on how to buy a home for nothing down. Whatever happened to nothing-down home purchases? Are they illegal?

My wife and I want to buy a home. We have good, stable income and excellent credit, but we don't have much cash except for closing costs. Is there any way we can buy a home without much cash?

ANSWER: Yes, buying homes for little or no cash down payment is done every day by thousands of home buyers. If you qualify for a Department of Veterans Affairs home loan, no down payment is required. Federal Housing Administration home loans require about 5 percent down payments. Private mortgage insurance home loans require 5 percent to 10 percent cash down payments.

Fannie Mae is experimenting with a nothing-down program for 97 percent of the home's sale price. The remaining 3 percent can either be borrowed or received as a gift. If you buy a foreclosure or real-estate-owned home from a foreclosing lender, you'll often find excellent low or no-down-payment programs.

Another way to buy for little or no cash is to assume an existing mortgage, and get the home seller to carry back a second mortgage for all or most of the balance of the sales price. If there is no existing mortgage, ask the seller to carry back the entire mortgage.

To learn which low or nothing-down mortgage programs are available in your area, work with an experienced mortgage broker. He or she has access to these programs from many lenders. Your realty agent can assist with finding homes with easy seller financing. One way or another, you can buy a home for little or no cash down payment.

Bank should know insurance facts

Q: I am getting a mortgage from a major bank, which requires my fire insurance coverage to equal the loan amount. Three insurance companies have told me the result is about 30 percent overinsurance, costing almost $400 extra per year for unnecessary insurance.

The loan officer has told my insurance agent and me that she doesn't want to jeopardize my loan by not following the bank's rules. It has been brought to my attention the bank's overinsurance requirement is illegal.

What should I do? Do I have any recourse?

A: I presume your mortgage loan has been approved. Educating the ignorant bank about the insurance amount should not jeopardize that approval. The reason many states have laws prohibiting overinsurance for more than a home's replacement cost is to discourage arson for profit.

Hopefully, you are buying a guaranteed replacement cost insurance policy. That is the best and only type of homeowner insurance policy you should consider. Such a policy will pay to rebuild the structure even if the replacement cost exceeds the policy limit.

Your insurance agent should contact the bank's loan officer who approved your mortgage and explain the lender is well-protected by a guaranteed replacement cost homeowner's insurance policy. If the loan officer still refuses to accept a guaranteed replacement cost insurance policy for less than the loan amount, your insurance agent should contact the lender's president to explain the facts of insurance.

It's OK to use several agents

Q: My husband and I plan to start shopping seriously for a home. We already have a real estate agent who is working to find us a home in an area we like. But we have decided to broaden our search to include another area. We would like to see our agent derive some benefit if we decide to buy a home in the area she doesn't cover.

Is it wise to have two, or even three, agents working in different areas, or should we stick with one agent?

A: One agent cannot possibly know all the neighborhoods in a large metropolitan area. Work with a different agent in each area you are considering for home purchase. If your first agent refers you to another agent in the second area under consideration, she will get a referral fee if you buy a home through that agent.

How to find lease options

Q: Lease-options make sense. But how can I find interested homeowners willing to commit to such an arrangement? Is there a reliable way to locate such folks other than through a real estate agent?

A: If it is any comfort, there is always a shortage of lease-option home sellers and a surplus of lease-option buyers. For this reason, I recommend home sellers who are having difficulty selling to advertise their homes for sale on a lease with option to purchase.

Because few lease-options are advertised in the newspaper classified ads, you need to become creative. One technique I've used, suggested years ago by my Florida investor friend Jimmy Napier, is to run a classified ad for several weeks under "Houses Wanted," such as: "Executive needs 3 BR, 2 BA home on two-year lease with option to buy. Call Jimmy 555-5555." You'll get only a few telephone calls from that ad, but that's all you need.

Another technique is to contact landlords advertising under "Houses for Rent." After you inspect a home you want to lease-option, tempt the landlord with a lease-option offer, such as offering to pay six or 12 months rent in advance. Instead of a security deposit, offer the landlord a few thousands dollars of nonrefundable option money. This is far more than the landlord was expecting to receive as a rental security deposit. Be sure also to offer the landlord a year's postdated rent checks so she won't worry about collecting rent.

Lender won't cancel PMI

Q: We are trying to get our private mortgage insurance canceled. Last October we contacted our lender and had to pay a $217 appraisal fee. The appraiser spent only about 15 minutes inspecting our condo.

A week later our PMI removal request was denied. We then wrote the lender requesting a reappraisal because the appraisal omitted two recent comparable sales in our building, instead using a sale more than six months old, a listing and a nearby loft sale.

We also included an analysis done by a Coldwell Banker agent, indicating a much higher value of our condo.

The lender refused to respond to our evidence. I believe the lender should have hired an independent appraiser rather than its salaried staff appraiser to control the appraisal. What recourse do I have to get rid of my PMI?

A: You are not alone. Does the lender still own your mortgage, or has it been sold? Ask. You have a right to know. If the mortgage was sold to Fannie Mae or Freddie Mac, the nation's largest lenders, their rules require loan servicers to end PMI when the loan-to-value ratio drops below 80 percent. Other reputable lenders use the same guideline.

Write a polite letter to the lender's president explaining the facts, requesting a reappraisal by an independent appraiser or immediate cancellation of your PMI premium. If the president refuses to cooperate, suing the lender in small claims court for refund of your $217 wasted appraisal fee is appropriate.

COLUMN: REAL ESTATE MAILBAG

LOAD-DATE: April 27, 1997

Evidentiary Exhibit Number 155

South Bend Tribune (Indiana)

April 26, 1997, Saturday, MICHIGAN, INDIANA, MISHAWAKA, TRIBUNE

SECTION: HOME, Pg. C6

LENGTH: 1015 words

HEADLINE: TIMES WHEN LEASE-OPTION HOME A PLUS * REAL ESTATE NOTEBOOK

BYLINE: Robert J. Bruss

BODY: Do you have plenty of cash and excellent credit to buy a home? Or are buyers lining up to buy your home? If you answered yes to either question, you are not a good candidate for a residence lease with option to purchase.

Are you "cash-challenged" for home down-payment cash, but you have good income? Are you a motivated seller whose home has been listed for sale two months or longer without much buyer interest? If you answered yes to either of these questions, you are an excellent lease-option prospective home buyer or seller.

What is a lease option?

A lease with option to purchase is a real estate sales and finance method. It is a lease for a fixed term, such as 12 or 24 months, often longer, with an option for the tenant to buy the home (or other real estate) at an agreed option price.

The lease-option owner-seller is obligated to sell at the option price, but the tenant-buyer is not obligated to buy. However, when a lease-purchase is used, the buyer is obligated to purchase at the end of the rental period.

A unique lease-option and lease-purchase feature is the rent credit. The tenant usually pays top rent for the residence. But a portion is credited toward the purchase price if the buyer decides to exercise the purchase option.

For example, on my lease-options the house rents for $1,500 per month with a 33 percent, $500 monthly rent credit when the option is exercised. If the tenant elects not to purchase, the rent credit is lost. Needless to say, the rent credit loss is a very strong incentive for the tenant to buy.

There are always more lease option buyers than sellers

Few lease-options are advertised. Most realty agents don't encourage lease-options because only part of the commission is paid up-front, with the balance paid when the option is exercised. The result is a lease-option shortage, with more buyers than sellers. However, smart realty agents realize a lease-option is better than no sale at all.

To create lease-options, smart home buyers run "house wanted" classified ads such as "Executive needs 3 BR, 2 BA home on two-year lease-option. Call Jim 555-5555." You won't get many phone calls, but all you need is one or two.

Another technique is to check the "houses for rent" classified ads. After inspecting a suitable house, offer to lease it with an option to buy. Most landlords find it hard to resist a tenant's tempting offer of nonrefundable option money instead of a security deposit.

Home seller lease option advantages

The primary lease-option advantages for home sellers include:

(1) Strong buyer demand. Whether a local home sale market is weak or strong, there are always more lease-option buyers than sellers. A lease-option usually solves a home seller's problem of getting enough monthly income to pay the mortgage payment and other expenses. Also, the seller receives the tenant-buyer's nonrefundable option money, typically several thousand dollars.

(2) Top dollar option price. Lease-option home buyers are usually willing to agree to a top dollar option price for the residence. This option price is usually the home's market value at the time of entering into the lease-option.

If the market value goes up during the lease-option term, the buyer benefits. If market value drops, the tenant often exercises the option because of the rent credit feature.

(3) Excellent tenants. Lease-option tenants usually take excellent care of the home because they plan someday to own it.

(4) Above-market rent. As a lease-option landlord, I find my tenants will pay 10 to 20 percent higher than market rent. For example, last year two of my tenants exercised their purchase option. They told me they considered the monthly rent to be a bargain $1,000 plus $500 in a rent credit "down payment forced savings account." I viewed it as $1,500 monthly rental income!

(5) Seller enjoys tax deductions. During the lease-option term, the seller enjoys tax deductions for the mortgage interest, property taxes and depreciation. If a tenant complains about the lack of tax benefits, a reminder of the rent credit benefits usually more than compensates.

Home buyer lease advantages

But lease-options are not one-sided. Advantages for buyers include:

(1) Little up-front cash required. Compared to a home down payment, the lease-option up-front cash required is usually very small. For example, when I have a house to lease-option, I run a newspaper ad headlined "$5,000 MOVES YOU IN." The $5,000 is allocated to the first month's rent plus the nonrefundable option consideration. This is usually far less cash than is required to buy a home.

(2) Rent credit builds a down payment. The higher the rent credit percentage, the greater the probability the tenant will exercise the purchase option. A low 10 percent rent credit is not much of an incentive to buy. But highly motivated home sellers offer 50 or even 100 percent rent credits to practically assure a sale.

(3) Try before buying. A special benefit is that tenants can try the home before buying. If it isn't a home they want to own, they won't exercise the option and the landlord benefits from the forfeited nonrefundable option money and lost rent credit.

(4) Control property with little cash. If the property goes up in market value during the rental term, the tenants leverage their investment. For example, as a buyer I once negotiated a 15-year lease-option to purchase a house worth $125,000. By the time I exercised the option 12 years later, it was worth $220,000.

(5) Rent credit is better than tax deductions. Although lease-option buyers don't enjoy any tax deductions, their monthly rent credit earned toward the purchase price is usually far more beneficial.

Summary. Lease-options offer benefits and solve problems for both home buyers and sellers. Lease-options can also be used with other types of properties. Further details are in my special report "How to Quickly Buy or Sell Your Home With a Lease-Option" available for $4 from Robert Bruss, 251 Park Road, Burlingame, CA 94010.

LOAD-DATE: November 23, 1998, Monday

Evidentiary Exhibit Number 156

Star Tribune (Minneapolis, MN)
February 8, 1997, Metro Edition

SECTION: Home; Pg. 4H
LENGTH: 3113 words

HEADLINE: Snowbird lifestyle requires know-how;
Decisions range from critical (rent vs. buy) to mundane (do I need to bring a coat?)

BYLINE: Jim Buchta; Staff Writer
DATELINE: Maricopa County, Ariz.
BODY:

Seasonal migration has its privileges, including the opportunity to avoid the extremes of Minnesota winters and Arizona summers.

But managing the snowbird lifestyle also can bring burdens, particularly if one domicile is in a climate where it's hot enough during the summer to melt plastic and the other is in a Jack London landscape where frigid weather can burst pipes.

The issues snowbirds need to consider range from the mundane - do I need to take a coat? - to the critical - do we rent or buy? There also are tax questions, insurance questions and residency questions to decide.

No doubt, snowbirding is fraught with contingencies, considerations and preparations. But that's part of the trade-off for a lifestyle that many Minnesotans embrace.

Choosing where to live

Sandy Karch-Dykhuizen and Les Dykhuizen have been considering relocating for most of the year to a warm-weather state after Sandy turns 55 this summer. The weather is their primary reason for leaving, but they're also interested in downsizing from their four-bedroom house in Maple Grove.

They've discovered that some houses in Sunbelt states tend to be less expensive than those in Minnesota. "And they should be," Sandy said. "Because they don't have basements, they have small lots and they're not insulated like our homes."

In many of the communities in Arizona that cater primarily to retirees, it's true that houses with basements are a rarity. But there also are fewer homes with stairs, and certainly none with ice dams.

The Dykhuizens took a tour of the Southwest last spring to help them make their decision. Because they considered weather such an important factor, they also requested from the Western Regional Climate Center in Reno, Nev., five years of weather detail (daily highs, lows and precipitation) for two cities (cost: $ 20).

They aren't sure what kind of "lifestyle" they want, so they've been contacting chambers of commerce, libraries and retirement groups to find out what kinds of activities are available for active retirees.

In contrast, when Jean and Gene Neumann of Minneapolis and Maricopa County, Ariz., made their decision about where to roost in the winter, they intentionally chose an RV park that didn't have lots of activities or amenities.

"If you don't use them, you're paying a lot of money for something you don't use," Jean Neumann said.

Rent or buy?

John Unger, a certified financial planner and senior financial adviser with American Express Financial Advisors, recommends renting a winter home before buying to be sure that you've made a decision that's right for you. By renting, you'll get an indication of what the cost of living in a particular community will be and you'll be free to check out different parts of the country.

Flexible rental situations are a hallmark of places such as Arizona, Texas and Florida that cater to part-time residents. One such project is the Racquet Club at Scottsdale Ranch, where golf courses and tennis courts give a country-club atmosphere,

Dorothy Moore, general manager and leasing/resale consultant for Racquet Club Realty (not associated with the homeowners association), said that the 40-acre, 395-unit complex allows owners to rent their units for a minimum of one month. The company will handle all rental reservations, maintenance and cleaning. Rents for the units, which range from 629 to 2,141 finished square feet, start at about $ 800 per month during the summer months. Rents are determined by time of year and length of stay.

Once you've made the decision to rent or buy, then you begin the search process. Looking for a home in the city in which you live is difficult, but long-distance house hunting in a community across the country is even more complex.

The best way to connect with a real estate sales or leasing agent is through a referral, either from an acquaintance, a professional association or local tourism office such as a chamber of commerce.

In Arizona, real estate agents can handle sales of mobile homes as long as land is part of the transaction. Otherwise, a special license is required to sell a mobile home on land that is leased, said Jule Andrews, sales agent for Re/Max Realty and president of the Phoenix Association of Realtors.

People such as the Dykhuizens who want to spend only a couple of months in Minnesota during the summer may have a more difficult time finding temporary housing if they want to rent. One option might be a corporate apartment, which usually is furnished and available with a short-term lease. Apartment-finding agencies such as Apartment Search and Fonahome are good options to find short-term rentals.

Cash or a mortgage?

People with enough money to pay cash for a second home often wonder whether financing the home is a better option. Unger said yes, in the current interest rate market. It usually is in their best interest to finance the home because many people who can afford to be snowbirds are in a higher tax bracket and can use the deduction.

But it's best to get your financial ducks in a row before you decide to assume responsibility for a second household. It's very important to look at the long-term costs, particularly if you're relatively young.

"Because of inflation and because they're [retiring] younger and everybody's living longer, you have to make sure that your financial assets are adequate to cover your needs in the long term," Unger said.

Prospective snowbirds also should do some serious estate planning with dual households in mind. If you have assets in two states when you die and only have a simple will, your heirs may have to pursue settlement through probate courts in both states. Unger suggests holding property in a revocable living trust, which will keep property out of probate.

Where's home base?

Making the decision to spend the winter months in a warmer climate may seem like a no-brainer. But for some folks, that decision opens a whole new can of spring-loaded desert rattlesnakes.

Perhaps the most difficult question to answer is how long to be gone. Some people stay away for as long as it's cold in Minnesota. But many snowbirds choose to leave for much longer. That raises two questions: How long you can legally be away from "home" before you're considered a permanent resident of your winter home state, and what are the implications of changing residency status.

In Minnesota, people who legally aren't residents of the state can't claim homestead property tax status on the house they own here. If you do claim Minnesota as your primary residence, then you may be entitled to homestead status. Residential non-homestead tax rates can be two to three times higher than the homestead rate, depending on the value of the home, which is set by the county or local assessor.

It's a common misperception that residency is determined by the amount of time you spend in a particular place. "We see a lot of letters that say, 'We're there six months and one day,' " said John Hagen, manager of the information and education section of the the property tax division at the Minnesota Department of Revenue.

"Basically, to get a homestead status there's no set time you have to occupy a property. To receive a homestead [credit] you must be a resident."

The property owner (or certain qualified relatives) must be a Minnesota resident, and must occupy the property as the primary place of residence. State statute does say that to claim a homestead tax credit the tax payer must reside at the property on Jan. 2, but that doesn't mean the owner needs to be living at the property at that time.

Renting out your Minnesota home while you're enjoying winter somewhere else is one of the activities that may jeopardize your homestead status, depending on how often you do it and for how much of the year. "It's a contradiction to say that you rent [out] your primary residence," added Hagen. Residency, the Minnesota Department of Revenue said, is based on several factors, including but not limited to where you pay income tax; the address on your driver's license; where your vehicle is registered; where you mail is delivered, and where you are a registered voter. Proving homestead status is the responsibility of the taxpayer.

License requirements

Although the Department of Revenue defines residency one way, other agencies may have their own definition.

For purposes of motor vehicle registration, Arizona considers a person a resident if they live there an aggregate of seven months per calendar year. At that point, they must get an Arizona license plate and driver's license. Residents pay an $ 8 automobile registration fee and a vehicle license tax is based on a formula that takes into account the car's age.

For people applying for an Arizona driver's license, there is a written test and fees ranging from $ 10 to $ 25. Licenses are valid for up to 12 years. After age 60 licenses should be renewed every five years, said Doug Nintzel, spokesman for the Arizona Department of Transportation motor vehicle division.

The Arizona Department of Revenue presumes that residency is established after nine months, said Dan Zemke, the department's public information officer. It also considers things such as vehicle registration and the state in which income tax returns are filed. Any money people earn in Arizona is taxable whether or not they are considered a resident.

Other states have their own rules about property tax rate classifications. Arizona's tax system benefits people who want to rent out their property because no distinction is made between homestead and non-homestead properties.

Arizona has a strict income tax policy that taxes residents on all income - regardless of source - but has a low personal income tax rate ranging from 3 percent to a high of 5.6 percent for single individual filers with incomes of $ 150,000 or more.

The state's sales tax varies by city and county. The state rate is 5 percent on retail purchases except food for home consumption and prescription drugs, among other exemptions, Zemke said.

Income tax vs. sales tax

Is it always a better deal to establish residency in a state that doesn't have a personal income tax? Maybe not if you're a prolific shopper. The benefit of establishing residency in another state such as Texas that doesn't charge a state income tax depends on whether or not the state charges a higher sales tax, John Unger said. But because retired people aren't likely to make lots of purchases, it usually makes sense for them to change residency to a state with no state tax, he added.

Insurance factors

Snowbirds and snowbird wanna-bees also should take a look at their auto, homeowners and health insurance coverage and premiums.

When weighing your options in this arena, advice from industry experts is filled with qualifiers: "There's nothing cut and dried about insurance. It varies from company to company and from policy to policy within the company," said Maggie Jensen, director of public relations for the Insurance Federation of Minnesota, a nonprofit insurance trade organization supported by the insurance industry. "And if you're not sure, read your policy. If you're still not sure, call your agent," Jensen said.

Generally, if you have one car, the premium is based on the area where you live the majority of the year.

If you have two cars - one at your winter home and one at your permanent home - consider canceling or putting on "lay-up" all coverages except for comprehensive coverage on the vehicle that's not being driven. Comprehensive coverage will protect the car itself, Jensen said.

Before you decide how many cars you'll keep and where you'll establish residency, check the cost of auto insurance in the states you're considering. The average 12-month auto insurance expenditure in 1994 in Minnesota was $ 619.90, ranking 22nd highest out of 48 states. Arizona was the 12th highest at $ 730.97, while Texas and Florida ranked 15th and 19th, respectively, according to a report published last year by the National Association of Insurance Commissioners.

Most homeowner insurance policies don't offer cheaper premiums to part-time residents. "The house is still there and susceptible to whatever ills might befall it," Jensen said. But there are special considerations for snowbirds. Policies generally require homeowners to take reasonable steps to protect their home while away.

While having a renter might jeopardize your homestead status, it might be a plus in the eyes of your home insurer. "That could constitute reasonable care if you have someone living in the house. That is a step toward making sure the house is OK," Jensen said. "What is reasonable care is open to interpretation. Ask your agent what steps you need to do to keep coverage intact while you're gone."

In 1991, Minnesota's average homeowners insurance expenditure was $ 370, 27th highest of 48 states. Arizona ranked 36th, Florida 29th and Texas was first with an average expenditure of $ 592, according to the Alliance of American Insurers' survey of homes with values of at least $ 125,000.

Health insurance

Coverage and premiums for health insurance are another quagmire where it's difficult to find definitive answers. Commercial indemnity health insurers such as State Farm and American Family do make provisions for out-of-network coverage but usually with a higher deductible and copayments.

"State-by-state comparisons of health insurance plans and premiums are difficult to make because every state is at a different stage in health care reform," Jensen said. "That means that a standard policy varies dramatically from state to state."

While Medicare coverage and eligibility requirements may vary from state to state, Medicare supplement plans (policies that pay for things Medicare doesn't pay for) do extend benefits to people outside the state they consider their permanent residences "no matter how long they're out of the state," said Karl Oestreich, corporate spokesperson for Blue Cross and Blue Shield of Minnesota, which provides supplement plans for about 138,000 seniors in Minnesota. That organization uses income tax filings to determine residency.

Two homes, two lives

Gene and Jean Neumann, who own a home in northeast Minneapolis and an RV near Apache Junction, Ariz., began exploring winter options in 1985. They spent a couple weeks during the winter at various places in Arizona and Florida, which didn't appeal to them because of the heat, humidity and bugs.

In 1991 they bought an RV and settled on an Arizona park. Every winter since then they board their their big red Cadillac and head south for four months with their dog and cat. Until this year they would just turn down the heat, empty the fridge and rely on the kindness of a neighbor to look after the house and snow removal.

For the most part, the routine worked fine. But last winter, their fortunes changed. When their son went to their house to check on things, he found water running out their kitchen door from a broken ice maker in their refrigerator.

A Minnesota relative made arrangements to replace their floor and carpeting and to air out the house - not an easy task during winter.

This year the Neumanns found a temporary solution to the problem of an unattended house. They've taken on short-term housesitters - Angie and Nick Demma. Ironically, the Demmas too are snowbirds of a sort; they've come south from Alaska.

Links to home

Technology has made made some aspects of snowbirding easier. At Del Webb's Sun City West Park Ridge Recreation Center, the computer room is buzzing with the hum of computer disk drives and the enthusiasm of the eight or so seniors who are mastering the personal computer, while volunteer instructor Thomas Cook gives students the low-down on backing up computer disks.

Computers are one of the tools snowbirds use to deal with being away from home for part of the year. They use them to e-mail relatives, manage their finances, do their banking and maintain correspondence. "They use it in a big way," Cook said.

John Waldron, public and community relations specialist for Del Webb communities, marvels at the way computers have changed residents' lives. "Five years ago that [computer center] was in a closet in another rec center," he said.

For some people, making sure that all of their personal affairs are taken care of becomes a post-retirement vocation, what with magazines and mail to reroute, and phones and utilities to cut off or start up.

"It is a bit of a nightmare," George Pelto said. He and his wife, Signe, began splitting their time between Minnetonka and Sun City West in 1993. But, he added,"When you have nothing but time on your hands, it gives you something to do."

Snowbird flight plan

Seasonal migrants can laugh at their snowbound Minnesota neighbors, but they have to do their homework before they fly the coop.

Can you blame them? While Jean and Gene Neumann are enjoying 70-degree bliss at their RV home near Apache Junction, Ariz., their house in northeast Minneapolis is being occupied by a housesitting couple from Alaska.

The Palm Ridge Swim and Fitness Center is one of four recreation centers at Sun City West outside Phoenix, where residents pay $ 126.50 annually to use such amenities. When completed, Sun City West will have 16,500 houses with 26 floor plans priced from the low $ 90,000s to the mid-$ 200,000s.

A big attraction at "active adult communities" such as the three Sun Cities near Phoenix are recreation centers such as Sun City West's Palm Ridge Swim and Fitness Center.

Nick and Angie Demma of Alaska are accustomed to Minnesota-like winters. They're housesitting in Minneapolis for snowbirds Jean and Gene Neumann, who spend the coldest winter months at an RV park in Arizona.

Computer classes, such as this one at Sun City West, are the rage among snowbirds, who use computers to e-mail folks back home, do remote banking and keep track of finances.

LEFT: Mary Youngberg and her husband, Charles, keep a condominium in Plymouth, where they live during the summer. During winters, they live in Sun City West. She enjoys playing tennis at Palm Ridge Swim and Fitness Center.

BELOW: The Youngbergs bought this "maintenance-free" casita for about $ 117,000 two years ago.
GRAPHIC: Photograph
LOAD-DATE: February 9, 1997

Evidentiary Exhibit Number 157

Chicago Tribune

February 8, 1997 Saturday, WEST COOK SPORTS FINAL EDITION

SECTION: NEW HOMES; Pg. 32; ZONE: W; Realty Q&A.

LENGTH: 782 words

HEADLINE: TIE-BREAKER;

A THIRD OPINION CAN HELP SELLER DETERMINE MARKET VALUE OF UNUSED LAND

BYLINE: By Robert J. Bruss, Tribune Media Services.

BODY:

Q--I own a rural parcel of about 5.6 acres that I'm considering selling. Other than the tax assessor's valuation, which I think is low, how can I determine the market value of my land?

Two Realtors recently valued my land at a difference of about $23,000, so they were of no help.

A--Vacant land is generally valued per acre or per square foot, based on recent sales prices of nearby comparable land. I suggest you hire a professional appraiser who is experienced appraising land in your vicinity. Then you will have a third opinion on your land's value.

Q--I have a few questions about lease-options. Which party usually pays the insurance, property taxes and other expenses? If the purchase option is exercised, is a regular sales contract then signed by the parties? When and how do the realty agents get paid? When are the inspections done? Are there any good books on lease-options?

A--Before answering your questions, please let me emphasize that the primary reason for using a lease-option is because the home buyer doesn't have a cash down payment. A secondary reason is that the home has not sold in the "regular way."

The key component of a lease-option is the buyer's rent credit toward the purchase price. I usually give 33 percent, but once when I was extremely motivated to sell, I gave a 100 percent rent credit. That house needed lots of fix-up work for which I didn't have the funds. During that year's lease-option period, my tenant (a college professor) fixed up the house so he could get a mortgage when he exercised his purchase option.

During the option period, the owner usually pays the insurance, property taxes and other expenses. However, as a lease-option buyer, I've negotiated to pay these expenses in return for lower rent. Everything is negotiable. Only the title holder, however, can claim depreciation and income tax deductions.

A good lease-option agreement provides all the sales documentation needed when the option is exercised by the tenant giving notice to the owner of intent to exercise the option. No further contract is needed.

The realty agent should receive a leasing commission when the lease-option is signed. The balance of the sales commission is paid to the agent when the option is exercised and the sale closes.

Any inspections should be done up-front so the tenant-buyer knows the condition of the house. As a lease-option seller, I specify in the contract the home is being sold in its then "as is" condition at the time the option is exercised. In other words, if the tenant damages the house, as the seller I'm not going to pay for repairs.

The only good source of lease-option information of which I am aware, I modestly report, is my report "How to Quickly Buy or Sell Your Home With a Lease-Option" available for $4 from Robert J. Bruss, 251 Park Rd., Burlingame, Calif. 94010.

Q--If I buy a new home before I sell my present home, how will the capital gains tax apply when I decide to sell my first home?

A--Presuming you have a profit in your present home, you can defer the profit tax if you sell it within 24 months before or after buying your replacement principal residence. To qualify for tax deferral, the cost of the replacement home must equal or exceed the net sales price of your old home.

In other words, no capital gains tax will be due if you sell your old home within 24 months before or after selling your old home and its cost equals or exceeds the sale price of your old home. Your tax adviser has further details.

Q--When my husband died about 12 years ago, I received a life estate in our home. After I die, it goes to the state university.

I am 67 and in very good health, but I want to move to a better climate. I talked to my lawyer, who says I can't sell my life estate. Is this true? I was hoping to get some cash to buy a condo in a warm climate.

A--Presuming your life estate does not require you to continue living in the house, you can sell your life estate. However, it probably won't produce much cash. The reason is that when you die, the life estate dies too.

Perhaps a neighbor will give you a few thousand dollars for your life estate. The neighbor can then rent the house to tenants.

Or you can hire a property management company to rent the house and you will receive the rental income. Either way, you won't receive much cash or income because a life estate that can end any moment isn't worth much.

Incidentally, if you sell the life estate, the buyer should take out an insurance policy on your life.

PLEASE NOTE: Real estate laws vary from place to place. Be sure to check the laws of your state and municipality before making decisions on real estate matters.

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Evidentiary Exhibit Number 158

The Washington Post

February 01, 1997, Saturday, Final Edition

SECTION: REAL ESTATE; Pg. F08; REAL ESTATE MAILBAG

LENGTH: 3876 words

HEADLINE: REAL ESTATE MAILBAG

BYLINE: Robert J. Bruss

BODY:

DEAR BOB: My husband and I have saved about $ 20,000 for a home down payment, but the problem we're encountering is that the mortgage lenders expect housing costs to be only 33 percent of family income. My husband and I have good jobs and perfect credit histories but we spend about 60 percent of our take-home income for rent for our two-bedroom duplex.

Do mortgage lenders really take that 33 percent figure seriously in high-cost housing areas? Do more reasonable lenders charge higher interest rates? -- Gaelen G.

DEAR GAELEN: The tough "by the book" mortgage lenders you've encountered who allow no more than 33 percent of family income for housing costs usually sell their mortgages into the secondary mortgage market. Fannie Mae and Freddie Mac buy most of those loans. They claim they are flexible about their mortgage rules but, as you discovered, they really aren't.

Fortunately, there are the understanding "portfolio lenders" who keep all or most of their home loans and don't sell them. These lenders, such as local community banks, can be more flexible than lenders who must sell their loans. Work with an experienced mortgage broker to find the portfolio lenders who can be flexible. However, I'm not sure even a portfolio lender will approve your mortgage taking up to 60 percent of household income.

The third type of lender, probably the best, is the home seller who will finance your purchase. These lenders usually don't care how much of your income goes to mortgage payments. They know if you don't pay, they can foreclose to get the house back and resell it for a second profit. Of course, not all homes can be bought with seller financing, so your selection is limited.

You are wise to address the mortgage problem before shopping for a home. I advise getting preapproved for a home loan so you'll know the maximum mortgage you can obtain. But it won't hurt to start shopping for a home with a real estate agent who can show you homes with seller financing, the best finance source of all.

DEAR BOB: We have been renting a house for four years and want to buy it as soon as our landlord will sell to us when he is ready to retire. I want to approach him and ask if we can rent to own now. He's a very good landlord; he just built a new carport and spent $ 1,700 having our trees trimmed.

What lease-option advantages should I emphasize to persuade our landlord to let us start building a rent credit now? -- Cathy M.

DEAR CATHY: Congratulations on deciding to buy the home you've been renting. After trying out your home for four years, it must meet your needs.

A one- or two-year lease-option should give you enough time to build up a rent credit for all or most of your down payment. Your rent credit should be at least 33 percent of the rent you pay.

Topersuade your landlord to sign a lease-option, list the advantages for him, such as: higher-than-market rent; a substantial nonrefundable option consideration (taking the place of a security deposit) of several thousand dollars; he keeps the income tax deductions, such as mortgage interest, property taxes and depreciation until you exercise the option; you could offer to take over the maintenance expenses, giving him a net lease, in return for a low rent; postdated rent checks he can deposit on the first of each month; and a tenant who will take good care of the place, because you plan eventually to own it.

DEAR BOB: Where can I get information on learning about real estate appraisals? -- Marilyn G.

DEAR MARILYN: If you want to learn how real estate appraisals are made, I suggest the book "Fundamentals of Real Estate Appraisal" by William L. Ventolo, Jr. and Martha R. Williams (Real Estate Education Co., Chicago). You'll find it in public libraries or in stock or by special order at bookstores.

After reading that book, if you want to become a real estate appraiser, you'll need to obtain an appraisal license for your state. For details, write to the appropriate state government office listed in the book. To qualify, you must take appraisal courses and pass the state appraisal license exam. But be aware there is an oversupply of appraisers, so today is not a good time to become an appraiser.

DEAR BOB: I am a fairly new real estate agent. I thought you might be interested in how your advice to present even ridiculous offers resulted in a $ 13,750 commission for my share of the home sale.

My buyer, who walked in our brokerage office while I had "floor time," wanted to make a low offer on an overpriced house. My broker told me, "Forget it." I presented the low offer anyway. The listing agent wasn't happy. But the seller counteroffered. To my surprise, my buyer accepted the counteroffer at about $ 32,000 below the asking price. Now I know why you advise presenting all offers. -- Marty W.

DEAR MARTY: Congratulations on your sales success. The legal reason even ridiculous purchase offers must be presented to home sellers is that an offer is a material fact, which a realty agent must disclose. But the practical reason, as you discovered, is that low offers often lead to counteroffer negotiations that result in property sales.

DEAR BOB: In 1996 my wife and I bought our first home. We purchased "subject to" an existing mortgage that does not have a due-on-sale clause. We did not formally assume the mortgage. Even though the mortgage is still in our seller's name, can we deduct the mortgage interest we paid? -- Austin J.

DEAR AUSTIN: Yes. Because you own the home and must make the mortgage payments or lose the property by foreclosure, you are entitled to the itemized mortgage deductions on your income tax returns. Millions of homeowners are in similar situations, where they make payments on home loans originally taken out by other borrowers. Your tax adviser can give you details.

DEAR BOB: We've been trying to sell our home for almost a year. At first, we tried to sell it ourselves. That didn't work.

We then listed it with a good realty agent for six months. She told us the market was "slow" and that was the reason our home didn't sell. We renewed her listing for 90 days. We received two offers, but they were far too low.

Next, we signed a listing with a "hot shot" agent who had a mile-long list of homes he'd sold in our town. But we were one of his 50 listings so we didn't get much of his time.

We took our home off the market for the holidays. Now we're ready to get it sold. It's a very attractive residence, in excellent condition, with many amenities. What should we do to get our home sold? -- Marvella C.

DEAR MARVELLA: When a home has been for sale almost a year, there is usually just one reason it hasn't sold. That reason is the house is overpriced.

Since you're starting fresh, please sell your home correctly. Start by interviewing at least three successful realty agents. Each agent will give you his or her listing presentation. It should include a written comparative market analysis. This form shows recent sales prices of comparable nearby homes and the asking price of neighborhood homes now listed for sale -- your competition.

Each agent you interview will give you an estimate of your home's sales price (market value) and a recommended asking price. Listen carefully to these expert opinions. These agents are in touch with the current marketplace.

If you sincerely want to get your home sold, sign a 90-day listing with the best agent. But before signing, be sure to phone his/her references of recent sellers to ask, "Were you in any way unhappy with your agent and would you list your home for sale with the same agent again?" If you don't overprice your home and you select the best agent for a 90-day listing, your home should sell during the busy spring home-buying season.

DEAR BOB: I sold my home in September and carried back a $ 14,500 second mortgage for the buyer. She made the October and November payments, both late. The December payment came on Dec. 20. I haven't received the January payment yet. How long should I wait? -- Daryl L.

DEAR DARYL: If it's any comfort, I have borrowers like that, too. I find if I give them any slack, they'll take advantage of me.

I suggest you write or phone the borrower, politely reminding her the monthly mortgage payment is due on the first of each month. Another reminder is appropriate if you don't have it by the 15th of the month. If you haven't received the payment by the first of the following month, it's time to start foreclosure when the payment is 30 days late.

Most borrowers quickly will cure their default, including the late charge and extra fees. They soon learn their lesson: It's very expensive to be late with mortgage payments. Your attorney can give you details.

DEAR BOB: My wife and I plan to sell our home in 1997 and move to Costa Rica, where we will probably buy a home. Although we are eligible for the "over 55 rule" $ 125,000 home sale tax exemption, our problem is our sale profit will be close to $ 200,000. Is there any way we can avoid tax on our entire profit? -- David McG.

DEAR DAVID: Yes. Just subtract your $ 125,000 "over 55 rule" exemption from your home's adjusted or net sales price. Then buy a replacement principal residence, even in a foreign country, costing at least as much as this "revised adjusted sales price" to defer tax on the remaining $ 75,000 of your sale profit.

DEAR BOB: I want to thank you for your frequent advice to make a small down payment when buying a home. Almost a year ago, we bought a very nice home with a 10 percent down payment and a 90 percent mortgage. All was going well until a freak storm caused our home to slip down the hill. It was declared unsafe by the city. Our homeowner's insurance company says our "super deluxe all-inclusive" policy doesn't cover this earth movement loss.

We've decided to walk away and let the mortgage company deal with the problem. They sent us threatening notices and we realize our credit will be hurt. But we're thankful we followed your advice and only lost our 10 percent down payment. What would you do in a situation like this? -- Mike R.

DEAR MIKE: I'm glad to learn you only made a 10 percent down payment and didn't have a major portion of your financial assets tied up in a home that became virtually worthless. If I were in your situation, I also would probably walk away and let the mortgage company take title to the house.

Your problem is that, in many states, depending on the circumstances and type of mortgage, the lender can seek a deficiency judgment against the borrower for its loss. Some lenders pursue deficiency judgments, others don't. Consult your attorney as to the best course of action.

DEAR BOB: I remember when home mortgage interest rates were high, the mortgage lenders used to give discounts to borrowers who paid off their low-interest-rate home loans. We have a $ 38,500 mortgage with a 6.5 percent interest rate, which we can afford to pay off. I wrote to the lender asking how much discount we will receive, because they can loan the money at a higher interest rate, but was told no discount will be given. Should I insist on a discount for prepaying this mortgage? -- Herb W.

DEAR HERB: No. Institutional lenders don't care if you prepay your mortgage. They no longer give discounts for early payments. Only if there is a great disparity between the loan's interest rate and the market interest rate is there any incentive to give prepayment discounts. That situation does not currently exist.

DEAR BOB: I met a woman who invests in real estate. Apparently, she has done very well by investing in probate properties. She has a technique of following the death notices in the newspaper, checking the court files to see if the deceased owned any real estate and, if so, contacting the estate to see if they want to sell.

Although this sounds like lots of work, she said the bargains are fantastic if she is patient. The best bargains, she said, occur when the heirs want cash and are willing to sell far below market value. Do you think probate properties are a good buy? -- Mervin T.

DEAR MERVIN: I've bought my share of probate properties but haven't found them to be exceptional bargains. Once I made an offer to buy a house but didn't succeed because the 29 heirs couldn't agree what to do.

If you wish to make a career of buying probate properties, you might do as well or better than your new friend. Because the heirs paid nothing for the inherited property, if they need money or are willing to finance your purchase, you might buy some bargains. It won't hurt to learn the probate procedures to see if you can buy some bargains.

DEAR BOB: We live in an "owner's apartment" in a combination apartment and commercial store building that we're selling. Our reason for the sale is the stairs to our second-floor apartment (no elevator) are too much for my wife. She is 68 and I am 74.

We received a very good offer from an adjoining supermarket, which wants to buy our building to tear it down for parking. Can we use that "over 55 rule" $ 125,000 tax exemption in a situation like this? -- Norm W.

DEAR NORM: Yes. However, the "over 55 rule" of Internal Revenue Code 121 only applies to your profit from the sale of your owner's apartment. It does not apply to the profit on the sale of the rental portion of the building.

You'll need to allocate the sales price between the value of your apartment and the value of the remainder of the building. Then your profit will be apportioned between the residence and rental portions.

Ask your tax adviser for assistance. Before the building is torn down, you should get an appraisal or some evidence of the value of your residence apartment to justify the allocation.

DEAR BOB: Like most young couples, we have good income but can't seem to save for a home down payment. A rent credit would be ideal to force us to "save." We saw a newspaper ad for a "lease-purchase." Is that the same as a lease-option? -- Dolores S.

DEAR DOLORES: No. A lease with option to purchase gives the tenant the option to buy the property on the specified terms. But a lease-purchase requires the tenant to buy the property on or before the deadline.

Both lease-options and lease-purchases usually provide for a rent credit toward the purchase price. This is critical for tenants such as you, who have good income but no down payment.

DEAR BOB: I've been reading the newspaper classified want ads and discovered there are many condominiums for sale at what seem like bargain prices. Are condos good investments? -- Dorcy W.

DEAR DORCY: The answer depends on whether you want to buy a condo for your personal residence or as a rental investment property.

Condominiums can be wonderful personal residences. I own one as a second home and enjoy it very much. However, I would never buy a condo as a rental investment.

Some of the reasons: Condos usually don't rent for enough to pay all the expenses, they usually don't appreciate in value as well as single family houses, and they can be very difficult to sell unless they are in a highly desirable complex.

DEAR BOB: We made an offer to buy a home. After negotiations back and forth, we finally reached a firm contract. We insisted our offer include a contingency for our getting a mortgage. We are new to the area, so we asked the realty agent for lender recommendations. She was of little or no help. Don't realty agents usually help home buyers arrange a mortgage? -- Ted N.

DEAR TED: Yes. Realty agents are in an excellent position to recommend mortgage lenders. I'm shocked your agent didn't drive you to a lender's office. Her sale depends on your getting a mortgage. She should realize "You can't sell it if you can't finance it."

Fortunately, obtaining a home loan is relatively easy today. Shop among several banks, mortgage brokers and mortgage bankers to find the best terms for your situation.

DEAR BOB: In May, we have a $ 23,000 second mortgage balloon payment coming due. Should we refinance our first mortgage, currently at 8.75 percent interest, or try to get a new second mortgage? The total mortgages on our home are now about 87 percent of its market value. Will we have a problem in May? -- Brent S.

DEAR BRENT: Yes. It is not too early to start shopping for mortgage money now. You will probably have great difficulty obtaining a new second mortgage, since the total loans will be at least 87 percent of your home's value. However, if you have a good banking relationship, you might be able to convince your banker to make you a home equity loan to pay off the balloon payment.

But it appears your easiest alternative is to refinance your first mortgage with a new 90 percent mortgage. Many lenders won't go that high on a refinance, but some will. All you need is one.

Work with an experienced mortgage broker. He or she should have contacts with several lenders offering 90 percent refinances. But don't look for a bargain interest rate, because the mortgage you will be seeking is very high risk for the lender, requiring PMI insurance.

DEAR BOB: We closed our home purchase last September and have been making the mortgage payments since then. But last month we received a letter from our lender explaining that the monthly payment on our 30-year fixed-rate mortgage was calculated in error. The lender wants us to pay a deficit of $ 276 and increase our monthly payments by $ 46. My son figured it out and, unfortunately, the lender is correct. Do we have to agree to increase our monthly payment by $ 46 and pay the $ 276 deficit? -- Holmes S.

DEAR HOLMES: If you don't increase your monthly payment to fully amortize the mortgage over 30 years, your loan will take more than 30 years to be paid off.

This appears to have been a unilateral payment mistake by the lender. You could hire a lawyer and refuse to adjust the payments, but it would probably be a costly losing fight if the interest rate and principal amount on the promissory note were correct.

DEAR BOB: I am a real estate agent with an ethics question. On several weekends I showed many houses to my prospective buyers but they didn't like any of them. Then they started working with another agent. He showed them a house they had already seen with me and made a purchase offer that, after some negotiation, was accepted by the seller. Since I showed that house first, do I have any legal claim to part of the sales commission? -- Evelyn T.

DEAR EVELYN: No. You did not obtain a "ready, willing and able buyer," which would entitle you to part of the sales commission. The only exception occurs if you belong to one of the very few multiple listing services that still have a "first showing rule." Then you would be entitled to part of the commission.

I realize it must be very frustrating for you to learn a house you showed to prospects was sold to them by another agent. However, if you think about the situation, it is very fair for the agent who obtained the acceptable purchase offer to earn the commission. Although you tried, you weren't able to get those buyers to make an offer, so you shouldn't receive any part of the commission.

DEAR BOB: Two months ago we moved into our new house, but we are undecided what to do with our former residence, which is being renovated and painted for either sale or rental. It is a three-bedroom, two-bath home about 40 years old, in a good neighborhood with great schools, where home values are rising about 3 percent annually. Would you sell this house or keep it as a rental? -- Jerome P.

DEAR JEROME: You can never own too much real estate. It sounds as if your former residence will make an ideal rental if it is near your new home and won't require a long drive to manage. Since it is appreciating nicely in market value, it should make an excellent long-term investment property.

However, if you decide to sell, do you have a profitable use for the money? If not, consider carrying back a first or second mortgage to make an easy sale for top dollar and to provide steady income for you.

DEAR BOB: About 12 years ago, I bought 21 acres in what was then a rural area; it was zoned agricultural. A few years later, the nearby city annexed my land and recently rezoned the land to residential, with only one home per acre. I'd been planning on building a shopping center because my land is located at the intersection of two busy roads. Although my attorney fought the downzoning, we lost. How much does the city have to pay me for the lost value of my land? -- Damon R.

DEAR DAMON: Nothing. There is no vested right to zoning. After public hearings, property can be rezoned and no payment need be paid to the landowner for the diminished value.

Only if the rezoning takes away all economic use must any payment be made to the property owner. This is why owners should not hold their land for future use. If you had applied for zoning to shopping center use before the city suggested residential zoning, you might have won. But now it's too late.

DEAR BOB: My wife and I are just starting to look for a home to buy. What is the best way to be sure we're not buying a lemon? -- Ben R.

DEAR BEN: When you find a home you want to buy, be sure your purchase offer contains a professional inspection contingency clause. It makes your offer contingent on your approval of a report of a professional inspector.

After your offer is accepted, be sure to accompany the inspector. He or she will point out any serious problems the seller did not previously disclose to you. Most inspectors will also give you an estimate of the repair cost. If the defect is serious, you can ask the seller to pay for repairs. Should the seller refuse, you can cancel your purchase and get your earnest money deposit refunded.

DEAR BOB: At an agent's Sunday open house, we found a home we wanted to buy, but we thought it was vastly overpriced, based on recent home sales we know about in the neighborhood. The realty agent was not very friendly when we mentioned these nearby home sales. When we told her we wanted to make an offer, she asked the price we were offering. We told her. She said she wouldn't even present such an offer to the sellers, so we dropped the matter.

But the house is still for sale and is vacant. We think our offer has a chance. How can we get the listing agent to present it? -- Gayle H.

DEAR GAYLE: Real estate agents must present all written offers to their sellers, no matter how ridiculous they might seem. The legal reason is that the offer is a material fact, which must be disclosed to the home seller under the agent's fiduciary duty to disclose all facts.

However, since you know the listing agent is unenthusiastic about your offer, which, I presume, is substantially below the seller's asking price, I suggest you find another agent to prepare and enthusiastically present your offer.

Expect a counteroffer. But negotiations back and forth might result in a sale. Until you make your initial offer, you'll never know at what price you can buy that home.

Readers with questions should write Robert J. Bruss at P.O. Box 280038, San Francisco, Calif. 94128.

LOAD-DATE: February 01, 1997

Evidentiary Exhibit Number 159

Sunday Times

December 22, 1996, Sunday

SECTION: Features

LENGTH: 1143 words

HEADLINE: On the point of recovery

BYLINE: Tim Dawson

BODY:

PROPERTY: Even though property prices did not rise throughout Scotland in 1996, the number of houses sold showed a definite increase, reports Tim Dawson

Since the boom and bust of house prices in England in the late 1980s there has been a tendency to view the property market in dramatic terms. Even in Scotland, where relatively few homeowners either made a mint or lost their shirts, perceptions that prices were either moving markedly up or dramatically down have still influenced both buyers and sellers.

Thus those looking to buy or sell decide on the basis of one report or another that the market is either for or against them. But a more careful look at the housing market over the past year suggests there are more complex factors at play.

Activity was depressed throughout Scotland in 1995. Even in central Edinburgh, where house prices have not dipped in living memory, the volume of property sold hit a historic low. In the west of the country, property values fell - albeit by only 1%-2%. Happily the picture for this year has been much rosier.

"We have sold 40% more properties this year than last," says Mark Hordern, marketing manager for the Glasgow Solicitors Property Centre.

To date, however, he says this renewed activity in Glasgow has done little for house prices. "There are a few areas, like the west end of the city, where demand is outstripping supply and prices are rising. But elsewhere the rise in demand has tempted many more sellers to put their properties on the market. What little rise there has been in prices has simply recovered the slight fall of the year before," he says.

In the northeast the recovery in prices has been more marked. House sellers are enjoying prices that are on average 5% higher than last year, according to estimates by the Aberdeen Solicitors Property Centre. "The interest-rate rises have not made much difference to us," says Malcolm Shepherd, the centre's deputy chairman. "It would take a massive hike to dampen the demand that we are seeing at the moment."

Price rises in the capital and the east of the country have been far less consistent than in the north, however. Results comparing the third quarter of this year with the same period last year show that in the centre of Edinburgh average house prices were up by nearly 7%. Modern detached villas in the city's suburbs had dropped in price by almost as much, however, although this was matched by a strong rise in the prices for older detached villas built since the 1920s. In both West and East Lothian, average prices dropped slightly, although average price rises across the Lothians grew by 2.17%.

George Clark, chairman of the Edinburgh Solicitors Property Centre, believes the market is rather stronger than his figures would suggest. "Closer analysis of these figures indicates that where prices have fallen this year it is because more small houses with fewer bedrooms have been sold," he says. "In East Lothian, for example,

although more properties are selling, a marginal drop in the average price achieved can be explained by the significantly higher proportion of properties for sale that were priced at or above Pounds 100,000 in the third quarter's sample."

Central Scotland fared even better. Average prices in Falkirk jumped by 15.4% during the third quarter and there were strong rises in Stirling and Clackmannan. The market for new-build houses also suggests that the recovery has been patchy. One or two developments have seen prices rise, but early reports suggest the general pattern is one of sales improving without spectacular growth.

"A year ago, buyers were not committing themselves until they knew they had sold their own houses," says George Sansome, Wimpey's sales and marketing director for the east of Scotland. "The improvement in the market this year means second-time buyers have tended to buy before they sell, as has been the usual practice in Scotland, and most of them have then found a ready market for their own properties."

Sansome blames local government reorganisation for adding to a sense of uncertainty in the market this year. "Sales have held up during the year, but we are hoping next year will be better," he says.

Looking beyond current price fluctuations for a broader picture of the housing market, it is not the number of house sales that is significant but the increasing size of the private rented sector. Before the second world war, the majority of the population rented their housing from private landlords. Although this was the predominant pattern in working-class housing, it was also regarded as normal for professionals to rent houses rather than buy.

By the end of the 1980s this sector had all but disappeared. The huge growth in council housing since 1945, and later the growth of private ownership, left landlords letting property to very few people other than students and the unemployed. By 1988 this sector accounted for only 4% of the housing market.

Since then, however, private renting has doubled, and, although it still accounts for only a tiny portion of the overall housing market, there are clear signs that it will continue to grow. Until recently it was almost impossible to borrow money to buy property to rent without paying punitive interest rates. In the past few months, several building societies have introduced packages targeted at the private landlord and some companies have started to build property designed for the private rented market.

"The new entrants to the rented sector are people under 32 who in the 1970s or 1980s would have bought houses," says Stephen O'Neill, who manages more than 200 rented properties in Glasgow. "Everyone associates renting with students and the unemployed, but tenants today are people with good jobs who are electing to rent and are putting off buying until they have a bit more money and a better idea of their long-term plans."

Small landlords who have bought one or two properties as an investment have fuelled the growth of this market but, says O'Neill, it is only a matter of time before heavyweight investors move in. "I am already working with one company that is building accommodation to rent as a long-term investment and I expect the building societies to commit themselves more heavily still to this sector," he says.

If O'Neill is right, it could signal the recovery of one of the worst-performing sectors of the housing market - first-time buyer houses. Figures for all of Scotland from the second half of 1996 show that while the average cost of all houses grew by 1.1%, this was despite a drop of nearly 1% in the average price of starter homes.

Ironically, if 1997 is the year when private renting starts to take off, it could be just the boost that people with property to sell in this sector have been hoping for.

LOAD-DATE: December 25, 1996

Evidentiary Exhibit Number 160

Los Angeles Times

October 20, 1996, Sunday, Home Edition

SECTION: Real Estate; Part K; Page 4; Real Estate Desk

LENGTH: 1576 words

HEADLINE: YOUR MORTGAGE;

REFINANCING CAN EXCEED HOME'S PURCHASE PRICE

BYLINE: ROBERT J. BRUSS, SPECIAL TO THE TIMES

BODY:

QUESTION: We bought our home about 21 years ago. Since then, it has more than doubled in market value. Within the next three years our two daughters will be entering college. Because mortgage interest rates are currently reasonable, we are considering refinancing our home mortgage now to borrow cash for their college tuition. Is there any way we can refinance for more than we paid for our home?

ANSWER: Yes. There is no legal restriction on how much cash you can obtain from refinancing your home mortgage. Most mortgage lenders will loan up to 80% of market value on a refinance, sometimes more.

However, if you decide to sell your home, you may owe tax on the "excess mortgage" that exceeds your home's adjusted cost basis. But you might be eligible for the "over 55 rule" $ 125,000 home sale tax exemption or the "rollover residence replacement rule" so don't worry about that possible problem now.

Reverse Mortgages From 'Big 4' Are Safe

Q: Thank you for your excellent reverse mortgage article some time ago. It was a godsend for my mother. I showed it to her, as I knew she was barely making ends meet. But she was too proud to say anything to me. Unfortunately, with two kids and only a schoolteacher's salary, I can't help her much financially. She called the reverse mortgage lenders you listed. She selected a plan that will give her $ 686 monthly as long as she stays in her home.

Although the reverse mortgage company seems sound, how secure are these monthly payments? I've heard of insurance companies going broke and failing to pay annuities. How safe are reverse mortgages?

A: The "big four" reverse mortgage lenders--Transamerica, Household, FHA and Fannie Mae--are all highly rated, multibillion-dollar organizations. I wouldn't worry about any of them failing to make monthly reverse mortgage payments to your mother.

However, there are smaller local and regional reverse mortgage firms I didn't mention because I feel they might not be financially stable. Several reverse mortgage companies have left the marketplace for various reasons. But the "big four" are probably as safe as possible.

Computing the Interest on Home Mortgages

Q: We closed the purchase of our first home on Aug. 25. Among our zillions of closing costs, we had to pay the interest on our new mortgage from Aug. 25 through Aug. 31. But we didn't have to pay a Sept. 1 mortgage payment. Our first mortgage payment coupon is dated Oct. 1, with a 10-day grace period. How can this be? Are we in default on our Sept. 1 mortgage payment? Did the mortgage company make a mistake?

A: No. Everything sounds correct. Home mortgage interest is collected in arrears. That means your Oct. 1 mortgage payment includes the interest the lender earned for the month of September. Don't worry: Lenders never forget to collect mortgage interest.

By the way, you should congratulate whomever handled the closing of your home purchase. I notice the sale closed on a Tuesday. That was very smart. If you had closed on a Monday, most mortgage lenders would charge you interest over the previous weekend even though you didn't yet have home possession.

However, the very best day to close a home purchase is on the last business day of the month, which was Aug. 30. Then you would only owe interest for two days in August but your first mortgage payment wouldn't be due until Oct. 1 (which is really Oct. 10 because of the grace period).

This High Interest Rate Is Perfectly Legal

Q: A retired friend tells me he invests in "discounted mortgages." She says they earn from 15% to 20% interest. Doesn't that violate the usury law? She says buying these mortgages is easy since she works with a mortgage broker and a real estate agent. Should I get into this field, as I would like 20% interest if it's legal?

A: It is perfectly legal for your friend to earn 15% to 20%, or more, on her money invested by buying existing mortgages at a discount. Her yield comes from a combination of the interest rate the borrower continues paying, plus the discount she receives by buying the mortgage for less than its loan balance.

When a Fixed Rate Is a Pretty Good Deal

Q: I'm in the process of trying to find a good mortgage so I can buy a townhouse. I can qualify for an adjustable rate mortgage with the payment and interest rate fixed for the first three years. After that, the interest rate is 2% above the 11th district cost of funds index. Is this a good deal? I will probably sell within five years.

A: Yes. Adjustable rate mortgages are good for homeowners who don't plan to keep their homes a long time. In my opinion, the safest index is the cost of funds index because it moves so slowly. That margin of just 2% above the index rate is excellent. Grab that loan.

How to Qualify With a Low Down Payment

Q: I read with great interest your answer a few weeks ago to a reader who has the same home buying problem I do. That is an inability to save for a home down payment. My apartment rent takes about one-third of my income. I also have a car lease, credit cards and student loan payments. As you suggested, I contacted an experienced mortgage broker. Since I am not a veteran, I don't qualify for the no-down-payment VA mortgage. The FHA loan limits are too low for buying a decent house in my area. The broker checked into the Fannie Mae 3% down-payment program, but I earn too much income and their loan limit is too low. This mortgage broker worked over a month to find a low-down-payment mortgage program for which I can qualify, even though I have a flawless credit report. Is there any hope I can buy a home?

A: Yes. Everyone who has a decent job can buy a home. Your first residence probably won't be your dream home, but it will be your first home. You can move up from there.

Saving the down payment is the biggest hurdle most first-time home buyers face. VA, FHA and Fannie Mae offer excellent home buyer programs. Unfortunately, your situation applies to thousands, perhaps millions, of prospective home buyers who don't qualify for those programs. Although you didn't mention PMI (private mortgage insurance), since you don't have a 5% or 10% down payment, you don't qualify for a PMI mortgage either.

My suggestion is to lease a home with an option to buy. By coincidence, in August I sold two houses to two of my tenants who had been renting houses from me on lease-options at $ 1,500 per month rent with $ 500 monthly rent credits. One buyer told me she viewed her $ 1,500 monthly payment as $ 1,000 per month rent and $ 500 per month into a "forced down payment savings account." I viewed the $ 1,500 as rent income!

Thanks to the rent credit, all she and her husband had to pay was about $ 2,000 of cash closing costs to buy the home. Lease-options are the most overlooked home-buying method. Fannie Mae, or some other creative lender, should use lease-options to stimulate home ownership. Lease-option details, including how to find and create them, are in my new special report "How to Quickly Buy or Sell Your Home With a Lease- Option" available for $ 4 from Robert J. Bruss, 251 Park Road, Burlingame, CA 94010.

Don't Be Afraid to Borrow to Buy a Home

Q: I think you're wrong to recommend people get a mortgage to buy a home. When I got out of the Army in 1947, I got married. We soon had our first child. For almost nine years we rented a one-bedroom apartment while we saved to buy a home. By 1955, we had enough money saved to buy a modest two-bedroom house for cash. Thanks mostly to inflation, we sold it in 1979 and bought a four-bedroom home for cash. Think of all the mortgage interest we saved. We managed to put our three children through expensive private colleges. Recently, we took out one of those reverse mortgages you wrote about to provide extra retirement income. Our motto is, "We're spending our children's inheritance."

A: Thanks for your wonderful letter. My parents paid cash for their home where I grew up. I am still amazed how they could save enough on my father's modest income to buy a large house without a mortgage. Today, that rarely happens.

I'll bet your children are buying their homes with the help of mortgages. There's nothing wrong with home loans. They enable homeowners to live better than they can as renters. As for your reverse mortgage, I congratulate you for being progressive enough to obtain the mortgage you never had when you were younger.

Don't Sell Mortgage; Try Hypothecation

Q: About three years ago I sold my house and carried back a $ 42,000 second mortgage at 8.5% interest only. The buyers pay right on time every month. Recently I received a letter from a mortgage broker offering to buy my mortgage. But he will offer me only about $ 28,000 for it. He explains it isn't worth $ 42,000 because of the low interest rate and 15-year term. I could use the money to pay some bills. Is there any alternative?

A: Yes. Instead of selling the entire mortgage at a big discount, just sell enough of the monthly payments to give you the cash you need. This is called hypothecation.

For example, you might want to sell the next five years of payments. After that, you get the mortgage back and receive the remaining payments plus the principal balance. Shop around. I'm sure you can get a much better offer by selling just some of the mortgage payments to an investor. Also, please consult your tax advisor about the hypothecation tax consequences.

LOAD-DATE: October 20, 1996

Evidentiary Exhibit Number 161

Press Enterprise (Riverside, CA)

October 7, 1996 Monday ALL ZONES

SECTION: BUSINESS; Pg. C11

LENGTH: 1690 words

HEADLINE: House rental companies benefit from recession;
Those who can't sell try renting

BYLINE: Rick Burnham, The Press-Enterprise

BODY:

When federal worker Stephan Thompson was transferred recently to San Bernardino from Lompoc, he started checking with residential property managers for homes to rent.

"I find it easier to go through property management companies," said Thompson, who had rented a house in Lompoc through a property management firm. "Things were done on time, and we were able to negotiate easier through the property manager. "

The residential property management industry appears to be benefiting from the state's five-year real estate downturn.

Many homeowners who can't sell their homes but need to move are renting their houses through property management specialists - companies that generally don't sell property and which in the past were employed primarily by people who had invested in rental dwellings.

The recession also has spurred many local real estate offices to open property management operations, seeking additional revenue and hoping to retain client contacts.

"I know of several offices - small, medium and large - that prior to the recession didn't do property management but which now have (them) as another profit center," said Andy Schnepf, owner of The Schnepf Co. in Riverside, which has managed and sold real estate for 14 years.

"What's happened is a lot of (real estate offices) had to go into property management to retain those customers," said Elmer McDaniel, owner of Rancho Plaza Realty Inc. in Temecula, which has been managing home rentals since the early 1980s. "Once the market comes back, they hope to have first crack at the listing" if the owner decides to sell, he said.

When Bruce Velich was transferred by his company from Temecula to a Minneapolis suburb in 1995, he decided to keep the Temecula home

he purchased in 1991 and signed with McDaniel's company to manage it.

"One of the reasons we kept the house is because we didn't want to lose our shirts selling it," Velich said. "We're also thinking of it as a long-term investment. And someday when we retire, perhaps we'll want to move back. "

Velich's major reason for hiring a property manager is that he's 2,000 miles away from Temecula. But even if he was in the same city, Velich believes he'd still use the firm.

"I've got a friend who invests (in houses) and doesn't use a property manager and it's a nightmare," Velich said.

The industry's growth hasn't been confined to Southern California.

"I'd say about 25 to 30 percent of the calls I get are from people who tell me, 'I can't sell, so I might as well rent'," said Robert Machado, owner of Sacramento Delta Property Management, which manages 1,500 houses and condominiums in the Sacramento area.

"Single-family residential property management has been exploding," said Machado, who also is the 1997 president of the National Association of Residential Property Managers. Since it was founded in 1988, the Chicago-based trade group's membership has swelled to more than 1,200.

An estimated 10 to 16 percent of the nation's single-family houses and condominiums are rented, and many are managed by professional property managers, Machado said.

Machado also credits the computer for the industry's explosive growth. Computers make it possible for smaller real estate offices to efficiently handle the 50 to 60 properties necessary to make the business profitable, Machado said.

"Before the computer, no one could take care of very many single-family properties because you have an owner for each property and it was too hard to keep track. But with computers, suddenly it becomes very profitable," Machado said.

Property management specialists often are the fastest and most reliable way to quickly find and rent good properties, tenants say.

Thompson, the new arrival from Lompoc, was able to find a four-bedroom home in Loma Linda suitable for his wife and four children after contacting Management One of Moreno Valley.

Management One's owner, Rod Sudman, said the company manages about 1,000 properties, primarily in Riverside County - making it one of

the area's largest property managers.

"They faxed me a list of their available properties complete with addresses, square footage and the monthly rental amount so I could narrow down which ones I really wanted to look at," Thompson said.

Some tenants rent first until they can decide where they want to live and whether they want to stay in the area.

For Michael Ribera, renting a house made sense four years ago when he moved to Riverside to accept a job as director of operations at the California School for the Deaf in Riverside.

At that time, the position wasn't permanent, and he already owned a house in West Los Angeles. "I had lived in an apartment and didn't like it (because) of the common wall and noise," Ribera said. "I also have animals. "

Ribera's job has since been made permanent, his house in West Los Angeles has been sold and he's considering approaching the owner about buying the Moreno Valley house.

While investors haven't been in the market in recent years, many continue to use property managers to handle investments purchased before the recession.

Michael Ekinaka of Irvine began investing in Riverside County houses in 1978. He now owns two houses in Riverside and two in Moreno Valley.

"I tried to manage the first one myself for two years and I finally decided there's got to be a better way," Ekinaka said. He didn't enjoy handling the maintenance, bookkeeping and other chores and turned the job over to Management One.

"From the investor's side, it's the easiest way to do it," Ekinaka said.

Easy and convenient, perhaps, but not free.

Most property management firms charge 7 percent to 10 percent of the monthly rent for their services. Some also charge a fee for finding a tenant - generally half of the first month's rent, said Mike Teer, president of the Riverside/Moreno Valley Area Association of Realtors.

Owner/landlords like Velich and Ribera consider the charges fair.

In return for their fees, most property management firms find and screen tenants, handle maintenance, often do semi-annual or annual property inspections and keep all financial records for the owners.

They also handle the messier parts of being a landlord - rent

increases and evictions.

"Fifty percent of what (the homeowner) pays for with us is our knowledge," said Management One's Sudman.

About 15 percent of the more than 1,000 properties under Management One's care are held by investors who own two or more houses, Sudman said. The remaining 85 percent own one or two houses - and about half the owners once lived in the property they're now renting, he said.

While the recession has benefited property managers, it also has created more turmoil. Some homeowners who decided to rent their homes when they couldn't sell find later they can't handle the extra expense.

"We're losing some accounts because properties are foreclosing," said Frank Heyming of H&J Property Management in Riverside, a company in business more than 20 years that manages more than 300 residential properties.

"Owners become upside down on the property (owe more than the house is worth), and some decide they have no other recourse but to walk away," Johnson said.

"We can end up with five to seven people (owner/landlords) a month losing their homes in foreclosure; that's not uncommon," Sudman said.

Still, Sudman often stresses to owner/landlords that they should consider their property an investment and not just a house to be rented until it can be sold. That philosophy obviously helps property managers retain owner/landlords.

But even for those whose mortgage exceeds the rent, it may make sense to hang on to the house if they can afford it, Sudman believes. There may be tax benefits to lessen the loss, and in future years when the market improves and home values climb, the house can be sold at a substantial profit, he said.

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Doing it right: For landlords and tenants
Tips for owner/landlords:

o Look for a reputable property manager, particularly if you're moving out of town, suggests Ken Willis of The League of California Homeowners, an Ontario-based consumer group. "A management company will make sure the home is taken care of properly and maintained," Willis said.

o "Spruce up the front lawn," says Ron Sudman, chief executive of

Management One in Moreno Valley, which conducts free seminars on property management. "Fifty percent of getting a home rented is the front lawn. People will spend $ 5,000 painting and fixing up the interior and the front lawn is dirt. Many people won't even get out of the car to look," he said. "Spend 10 more dollars on a flat of flowers at the front door. "

o If you're making improvements to rent the house, do them quickly, Sudman said. Every day lost means lost rental revenue.

o Don't let tenants fall behind in paying the rent, suggests Frank Heyming of H&J Property Management in Riverside. Work out a payment arrangement, he said, because a tenant who is behind on rent often has trouble catching up.

o Be good to your tenant. If you lose a tenant who's been paying $ 1,000 a month, you could end up losing two or three months' rent before you find a new tenant, Heyming said. And if the market is depressed, you'll get less than $ 1,000 a month from the new tenant.

Tips for tenants:

o "Find a property manager that will spend time learning what you want; it will cut your looking time 75 percent," Sudman said. Look for companies with a large selection of properties.

o Consider the service you'll get once you've signed a lease, Sudman said. If repairs are necessary, what resources does the company have and how quickly will repairs be made?

o Don't get evicted, said H&J's Heyming. "Go to the landlord and work it out somehow. " A tenant who has been evicted may have a tough time finding another apartment.

The Press-Enterprise
NOTES:

Includes info box.
GRAPHIC: PHOTO [Caption] Kurt Miller; The Press-Enterprise; Stephan Thompson found a home to rent in Grand Terrace using a property management company.
LOAD-DATE: August 15, 1997

Evidentiary Exhibit Number 162

THE PRESS-ENTERPRISE
October 5, 1996, Saturday

KR-ACC-NO: 19961005000188
LENGTH: 1303 words

HEADLINE: CALIFORNIA HOUSE RENTAL COMPANIES BENEFIT FROM RECESSION

BYLINE: By Rick Burnham

BODY:

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Many homeowners who can't sell their homes but need to move are rentingtheir houses through property management specialists -- companies thatgenerally don't sell property and which in the past were employed primarilyby people who had invested in rental dwellings.

The recession also has spurred many local real estate offices to openproperty management operations, seeking additional revenue and hoping toretain client contacts.

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Some tenants rent first until they can decide where they want to liveand whether they want to stay in the area.

For Michael Ribera, renting a house made sense four years ago when hemoved to Riverside to accept a job as director of operations at theCalifornia School for the Deaf in Riverside.

At that time, the position wasn't permanent, and he already owned ahouse in West Los Angeles. "I had lived in an apartment and didn't like it(because) of the common wall and noise," Ribera said. "I also have animals."

Ribera's job has since been made permanent, his house in West LosAngeles has been sold and he's considering approaching the owner about buyingthe Moreno Valley house.

While investors haven't been in the market in recent years, manycontinue to use property managers to handle investments purchased before therecession.

Michael Ekinaka of Irvine began investing in Riverside County houses in1978. He now owns two houses in Riverside and two in Moreno Valley.

"I tried to manage the first one myself for two years and I finallydecided there's got to be a better way," Ekinaka said. He didn't enjoyhandling the maintenance, bookkeeping and other chores and turned the jobover to Management One.

"From the investor's side, it's the easiest way to do it," Ekinaka said.

Easy and convenient, perhaps, but not free.

Most property management firms charge 7 percent to 10 percent of themonthly rent for their services. Some also charge a fee for finding a tenant-- generally half of the first month's rent, said Mike Teer, president of theRiverside/Moreno Valley Area Association of Realtors.

Owner/landlords like Velich and Ribera consider the charges fair.

In return for their fees, most property management firms find and screentenants, handle maintenance, often do semi-annual or annual propertyinspections and keep all financial records for the owners. They also handlethe messier parts of being a landlord -- rent increases and evictions.

"Fifty percent of what (the homeowner) pays for with us is ourknowledge," said Management One's Sudman.

About 15 percent of the more than 1,000 properties under ManagementOne's care are held by investors who own two or more houses, Sudman said. Theremaining 85 percent own one or two houses -- and about half the owners oncelived in the property they're now renting, he said.

While the recession has benefited property managers, it also has createdmore turmoil. Some homeowners who decided to rent their homes when theycouldn't sell find later they can't handle the extra expense.

"We're losing some accounts because properties are foreclosing," saidFrank Heyming of H&J Property Management in Riverside, a company in businessmore than 20 years that manages more than 300 residential properties.

"Owners become upside down on the property (owe more than the house isworth), and some decide they have no other recourse but to walk away,"Johnson said.

"We can end up with five to seven people (owner/landlords) a monthlosing their homes in foreclosure; that's not uncommon," Sudman said.

Still, Sudman often stresses to owner/landlords that they shouldconsider their property an investment and not just a house to be rented untilit can be sold. That philosophy obviously helps property managers retainowner/landlords.

But even for those whose mortgage exceeds the rent, it may make sense tohang on to the house if they can afford it, Sudman believes. There may be taxbenefits to lessen the loss, and in future years when the market improves andhome values climb, the house can be sold at a substantial profit, he said.

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HEADLINE: Money management

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A pension plan that favors older doctors

Q

A colleague says I could lower the pension contributions for my staff by switching from a money-purchase plan to a target-benefit plan, because my employees are considerably younger than l. How does a target plan work?

A

As with a money-purchase plan, annual deposits are limited to 25 percent of a corporate participant's salary (or 20 percent of an unincorporated doctor's net practice earnings), up to a yearly maximum of $ 30,000. But target-benefit plans also factor in each participant's age when calculating annual contributions. First you decide what size benefit you want at retirement. Then your pension consultant figures how much you'll have to put in each year (including investment earnings) to reach that target. You must set proportionate targets for your employees. But since they're younger than you, there's more time to build up their retirement fund, so you can contribute less for them than for yourself.

Investment performance has no effect on contribution rates. For example, if you assume a 6 percent average return, but your portfolio actually earns 10 percent, your annual contribution rate doesn't change, and you wind up with a bigger fund than anticipated. By the same token, poor investment results mean you'll get less at retirement.

What to look for in travel insurance

Q

I'm shelling out around $ 10,000 for a deluxe tour of Europe. Should I buy travel insurance?

A

Yes, but trip cancellation and interruption insurance is expensiveabout $ 5 to $ 7 per $ 100 of protection-so buy only enough to cover the non-refundable portion of your payment. If the cancellation penalty increases as the departure date nears, take that into account.

Be sure you understand the policy's limitations. For instance, will it allow you to cancel or cut short your trip if a family member who's not accompanying you becomes ill? If so, will you be reimbursed for the cost of transportation back home? Are pre-existing conditions included? Are you covered in case of other unforeseen circumstances-and if so, which?

To protect yourself against default by a tour company, it's best to purchase the coverage from your travel agent or an insurance company, not directly from the operator.

A double-dip that's legal, if you watch your step Q

I teach part time at a medical school with a 403(b) pension program. That would allow me to take a salary reduction and use the money to buy a tax-sheltered annuity. Can I participate, even though I also contribute to a 401(k) fund in my practice?

A

Yes, provided you don't put more than $ 9,500 total into both of them in 1996 (the limit is inflation-indexed). Be careful not to exceed the ceiling, because an excess contribution could be taxed twice if the error isn't rectified by April 15 of the year after it was made.

If your home's in a trust, you'd better stay put

Q

I've read that putting my house into a personal-residence trust and giving title to my children after 10 years would save estate tax. But what happens if I die or move before the end of the term ?

A

The potential tax saving is based on the fact that the waiting period reduces the present value of your gift. If you die prematurely, the house will be taxed at full value as part of your estate. If you move or sell before the term is up, you'll have to dissolve the trust or transform it into a different kind of trust with fewer tax advantages.

Suppose you decide to live elsewhere and rent the house out. You could put the property into a "grantor retained annuitytrust." A GRAT can hold income-producing investments, including real estate.

As with a residence trust, the assets' value is discounted, because the beneficiaries will get them in the future. However, the GRAT must make minimum annual distributions to the person who set it up. So at least part of the rent payments will come to you and could increase the size of your estate. The bottom line: Think twice before setting up a personal-residence trust unless you're pretty sure you'll stay put.

Choosing between two forms of joint ownership

Q

My wife and I are buying a retirement home in Florida, and our agent has asked us whether we want to hold title as joint tenants with right of survivorship or as tenants by the entirety. How do these forms of ownership differ?

A

Either you or your spouse could dissolve a joint tenancy during your lifetime and give or sell your half interest to anyone. If you hold title as tenants by the entirety-a form available only to married couples-the law in most states requires that you both consent to the dissolution. (In New York and a few other states, however, that's not necessary.)

For married couples, federal tax law treats both forms of ownership the same way: Half the property's value is included in the estate of the spouse who dies first. The marital deduction shields it from estate tax, since the property can't be disposed of by will and must pass to the surviving spouse. For capital gains tax purposes, the

decedent's half is valued as of the date of his or her death; the tax basis of the other half is its original cost. State tax laws may vary.

Tenancy by the entirety may help protect your property from creditors, if your state's law bars a transfer to satisfy a judgment against one owner. Otherwise, there seems little reason to prefer it to joint ownership. In most states that permit tenancy by the entirety, the law presumes this form of title if the deed doesn't specify which applies.

How condo and co-op ownership differs Q

We're thinking of selling our house and buying a condo or co-op. How do they differ?

As a co-op owner, you're a stockholder in the corporation that owns the building. You don't own your apartment, but you have the right to lease it. Your monthly maintenance payment also covers your share of the cooperative's mortgage obligation. In a condominium, you own real estate-not stock. This makes it easier, and often less expensive, to get financing. That's one reason condos tend to appreciate faster than co-ops. Another reason: In some co-ops, you must sell to the corporation or give it a percentage of your profit. In any case, the board of directors has the right to approve your buyer. Such restrictions rarely apply to condo sales.

Condo owners have more freedom to do what they wish inside their unit, though exterior changes usually require approval. In a co-op, all renovations are subject to board control.

Generally, you get tax deductions for mortgage interest and property taxes with either a condo or a co-op. If it's your principal residence, you're also entitled to defer payment of capital gains tax when you sell, and you can claim the $ 125,000 lifetime exemption if you're eligible.

Whether home improvements will pay their way

Q

We're about to put central air conditioning into our home, and I'm wondering what other improvements would add value to it. Any suggestions?

A

Remodeling the kitchen and adding a bathroom or family room are among your best bets, but don't expect to recoup their cost if they make your house too pricey for the neighborhood. People who are willing to pay more than the going figure in your area likely will buy in a more expensive neighborhood. Go ahead with improvements you feel are desirable for your own use, but check with a couple of experienced real estate brokers before you put money into others merely to enhance your home's sales appeal.

Remember, too, that poorly designed renovations can actually put buyers off. For instance, if you're planning on adding a bedroom, it's important to provide direct access to it-not through another bedroom. And by all means include a companion bathroom.

Claiming a tax loss on a vacation home

Q

I plan to live in my new resort condo Q one month during the year and put it into a rental pool the rest of the time. Since it's not likely to be tenanted for more than six months, I'm sure to show a loss for the year. Will I be allowed to claim it on my tax return?

Maybe. Your deduction is limited to no more than your rental income if your personal use exceeds 10 percent of the total yearly rental use. If you rent it out for six months or less, the IRS would contend you don't qualify for the deduction, because your personal use would come to at least 16 percent (1/6) of total rental use.

However, the Sixth Circuit Court of Appeals recently held that the entire period a unit is in a rental pool counts as rental use, even if untenanted, if the rental pool pays the owners a "fair rental" amount for that period. By that standard, your personal use would account for 1/2 or about 8 percent, making your loss deductible. Chances are, though, that the IRS won't follow this decision outside the Sixth Circuit (Kentucky, Michigan, Ohio, and Tennessee). E

Sidebar:

Comparing brokers' quotes when buying muni bonds I'd like to put some municipal bonds in my portfolio, and I've picked out a number of possibilities. But as a first-time investor in municipals, I wony about being overcharged. How should I go about buying them? Shop around among various firms, trying to find brokers who specialize in municipal bonds. Besides getting bond ratings and prices, inquire about spreads-the difference between the "bid" price the broker pays and the "ask" price you'd pay. Prices can change daily, so be sure to get quotes at the time you're ready to buy.

What if you find a good deal at a firm where you don't have an account? No problem. You can buy the bonds from that broker and have them transferred to your account elsewhere, if you want your entire portfolio in one location.

Reference:

Answers to non-investment questions have been supplied by editorial consultants listed on the masthead and by outside sources. Answers to questions on specific investments are the consensus-not necessarily unanimous-of . Larry W. Carroll, CPA, CFP, president, Carroll Financial Associates, financial planners, Charlotte, N.C. . Stanley Heilbronn, first vice president, Merrill Lynch, Pierce, Fenner and Smith Inc., New York David M. Kirr, president, Kirr, Marbach & Co., investment managers, Columbus, Ind.

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BEST PLACE TO MAKE AN ALIEN CONNECTION

Whangdoodle

24 West Camelback

264-9496

Alien is beautiful at Whangdoodle, the quirkiest gift shop in town. It's as tasteful as a Russ Meyer movie, and just as entertaining. Imagine an alternate universe located at the intersection where Mexican-folk kitsch meets UFO cultdom. Throw in garish '60s souvenirs (3-D playing cards depicting topless females) and some cheesy vintage household items (blue porcelain poodle paperweights with puppies attached by chains), and you begin to sense the utter dizziness of this establishment.

At Whangdoodle, Virgin of Guadalupe Lucite stick-shift knobs share shelf space with alien dolls made by a local UFO abductee. Mexican Day of the Dead vignettes sit beside truly awesome Jetsons-style furniture. And the sartorial selections range from horrendously weird tee shirts (one version stars Jeffrey Dahmer) to frighteningly bold vintage clothing such as the perfect orange-and-green terry-cloth jacket we spotted. And don't miss the alien-head pendants with eyes made from tektites (a type of meteorite), and voodoo candles and spooky potions.

Whangdoodle is a shrine to lunatic-fringe silliness, and we worship there regularly.

BEST PLACE TO BUY BOOTS TO MAKE REX ALLEN CRY

Botas Juarez

4231 South Central

268-9068

If Rex really wanted to walk on the wild side, he would tool down Central in his gold-plated Cadillac to Botas Juarez, a sort of mecca for local cowboy-boot enthusiasts. There behind the shop's three-alarm turquoise-and-fuchsia facade, he'd find traditional American-made Tony Lamas, but he'd likely blow right past them once he got a load of the shelves of Mexican boots made from alligator, water moccasin, python and mule.

The colors are as radical as the hides are exotic--our favorites were brilliant turquoise numbers featuring bumpy, politically incorrect alligator-head scales on the toe. The price varies depending on what's featured on the toe, with alligator-head scales commanding up to $795. For those who prefer a more refined, kinder-gentler alternative, Botas Juarez vends boots decorated with piteo, an intricate geometric embroidery using thread made

from the maguey (the same agave plant that produces tequila). Its pale cream color contrasts boldly and elegantly on simple black or brown cowhide.

Irresistible? Whip on down to Botas Juarez and, as they say in the footwear biz, just do it.

Readers' Choice for Cowboy Boots: Saba's Western Stores

BEST PLACE TO BUY A HAT TO MAKE DWIGHT YOAKAM CRY

Perryman Western Wear

4648 North 16th Street

279-5814

Since Rolling Stone revealed that Dwight Yoakam was shielding his male pattern baldness under his famous hat, we've become more sympathetic to the country sex symbol. So here's a tip, Dwight, should your stampede string break next time you're in the Valley: Head directly to Perryman Western Wear.

Fortunately for cowboys everywhere, Perryman has got religion about good hats. And you don't have to pay country-star prices, either. With more than 1,000 hats in stock, Perryman offers complete services--stretching, shaping, repairing, blocking, cleaning, hatband replacing and general renovating.

If you're one of those picky types who just can't buy off the rack, Perryman will be glad to create a private-label custom felt for you--all the way up to a top-of-the-line "100x." The rest of us mortals can select from fine hats by Stetson, Resistol and Larry Mahan, and straws by Charlie One Horse.

High standards have been set by owner Ron Perryman, who patronized the store during its 21-year run as Stockman's, then bought it in 1994 and promptly expanded its hat services. Maybe you can't wear your trousers as tight as Dwight does, but get to Perryman Western Wear before he does and you can out-brim him any old day.

BEST PLACE TO BUY A MAN'S BIKINI

Parr of Arizona

527 East Dunlap

395-6654

Hey, guys, if you're looking to minimize what you leave to the imagination at the beach or pool, you're probably in the market for one of those flat-out exhibitionist (a.k.a. butt floss) bathing suits--you know, a real man's bikini. Some may argue that's an oxymoron. Meow.

But ask around for the best place to buy a man's bikini and you're likely to get a reaction ranging from "Eeew, gross" to the deadpan "You don't really want one, do you?"--particularly if you're asking a woman.

The more modest styles favored by aqua-Olympians are available just about anywhere from discount stores to sporting-goods shops. But if you're truly looking for skimp, Parr of Arizona is the Valley's premier pouch palace, offering exclusively its own minimalist designs since 1958. It arguably carries the state's largest selection of male swimwear and undies, including traditional bikinis, t-backs, square cuts and tie-sides. If you're buff enough, go for it. We recommend you check your self-consciousness at the door.

BEST PLACE TO BUY CLOTHES NOW FOR A.D. 2001

Uh Oh

Hilton Village

6137 North Scottsdale Road, Scottsdale

991-1618

Ever notice how what's up to the minute in a shop's dressing room can turn into a "fashion don't" 20 minutes after you get it home? Where, oh, where, are the simple, elegant, seasonless pieces that endure the trends?

Uh Oh is where. Its fashions are classic but not boring, chic but not showy and, above all, they're going to stay that way for a while. A favorite of ours was the one country star Pam Tillis picked for her appearance on The Tonight Show With Jay Leno--an exquisite gray swing jacket and pant ensemble.

BEST MEN'S FITTING ROOM

Neiman Marcus

Fashion Square

Scottsdale Road and Camelback, Scottsdale

990-2100

"Good clothes really make you feel great," the saleswoman tells us, noticing the fine job we'd done picking out two short-sleeve shirts. "No matter where you go, if you're wearing nice clothes, you feel good about yourself."

We agree, and we think it's pretty darn neat when you can go to Neiman Marcus and sweat into some of those fine clothes just to feel good for a few scant minutes. You've seen them--clothes that look like your average, garden-variety decent duds, but cost as much as a large household appliance.

The saleswoman quits her sartorial musings and shows us to a fitting room that would be considered a three-bedroom ranch house in some parts of the Valley. The heavy wooden door and locked metal knob must be there to prevent squatters, we think. There are two elegant, folding-steel lamps on either side of us, and a wide bench. We plop our keys on a convenient oak tray mounted on one wall to hold bulging money clips or other items that don't often end up in our pockets.

We peel off our peon's rag of a shirt and don a light peach-orange, vaguely transparent button-down with a $285 price tag. We look into the tall mirror--and something changes. We feel different, as though a curse has been lifted. We are no longer the broke, humble shopper that entered this den. No, now we feel great!

We are reborn, saved! We are the equal of Ross Perot, Donald Trump and Ann Symington! These clothes, this fitting room, this store--and we, too, are now part of this better world of unrestrained luxury, of infinitely procurable happiness, of total financial liberty! God bless the USA!

Then we take off the shirt and go home, our Cinderella story finis.

BEST WOMEN'S FITTING ROOM

Capriccio at the Borgata

6166 North Scottsdale Road, Scottsdale

991-1900

If we have a shopping peeve--and we do--it's dressing rooms with no mirrors. We either have to decipher the fit by Braille or creep out to the store proper--where the shelf we call a butt earns an embarrassing new prominence, and shop personnel mass like starlings and agree with one another in too-shrill voices that bile green really does something for us.

The ideal fitting room has mirrors. Plural, for checking behind and sideways, just on the off chance that the entire population of the world isn't going to line up to view us squarely from the front for the life of the garment. The room should be well-lighted but naturally so--certainly not with those sickly violet bulbs that distort not only the color of the clothes, but our skin and hair as well. And the room needs a chair.

Capriccio is the place to get fit. Its roomy fitting rooms are well-lighted, amply mirrored and furnished with two chairs, so a trusted friend can come along to consult. To spend that kind of money, you want a witness.

BEST GAME STORE

The Jester's Court

11841 North 19th Avenue

943-8038

Sometimes, you want to go where everybody knows your game. Maybe you're one of the old guard still playing Axis and Allies. Maybe you're riding the wave of Magic: The Gathering. Or maybe you just like to watch.

The Jester's Court offers a sanctuary for those fleeing the dark forces of curfews and puzzled parents. But don't expect to find such board legends as Monopoly or Chutes and Ladders here. Nope, this is the spot for hard-core dice throwers and chart checkers, accustomed to screwing their butts to a chair for long periods of time.

Groups of tables dominate the center of the store, whose offerings tend toward the role-playing variety. Flapping cards, rolling dice and debates over character-stamina levels only hint at the clouds of imagination hovering over the players.

The Jester's Court knows its customers: It encourages organized groups and stays open for gaming until midnight on weekends.

BEST COMPUTER GAME STORE

Incredible Universe

2300 West Baseline, Tempe

431-5800

We aficionados of all things electronic make regular pilgrimages to this silicon shrine, where our prayers are answered. Once we offer our tithes (or at least our names and addresses) to gain acceptance to this holy land, we are rewarded with a selection of computer games and equipment that is unsurpassed: rows upon rows of games, from the old classics like Tetris to the hottest new death-and-destruction offerings like Quake. And Incredible Universe offers game equipment, too--the tools and equipment upgrades you need to make your games louder, bigger, faster, better.

We like to earn our sainthood by mastering the hottest new games at home, then playing them on the in-store demos, blasting away the high scores and drawing a gaggle of gape-mouthed, prepubescent worshipers.

Readers' Choice for Computer Games and Software: Best Buy

BEST FLOWER SHOP FOR GUYS WHO DON'T HAVE A CLUE

Daffodils

212 North Central

257-1868

Valentine's Day. We were confused, desperate for flowers--but which flowers? We don't know azaleas from zinnias, and how could we be sure our flowers would say "I love you," and not "Deepest sympathy in your bereavement"?

We were headed up Central Avenue pondering our options when we stopped right on Tex Benecke's star amid the "Walk of Fame." There, right beside Tex, at the foot of the San Carlos Hotel, we found our solution--Daffodils, the virtual support group for the florally challenged. Our leader, a kind and knowledgeable counter lady, made picking posies practically painless. Patiently walking us through the arrangement, stem by stem, she suggested gorgeous blooms far too exotic for us to name. We left with an armful of beauties, made our delivery and were proclaimed a hero.

You might say we went into Daffodils, and came out smelling like a rose.

BEST PLACE TO SCORE FREE SNACKS

Price Club

3801 North 33rd Avenue

(and other Valley locations)

274-1751

Whoever said there's no free lunch obviously has never been to the Price Club.

During our last visit to the members-only warehouse store, the free eats included cocktail-size servings of tamales, egg rolls, pasta, guacamole, burritos and fish fillets. On previous visits, we've enjoyed enchiladas, chocolate candy, toast and jelly, and fried chicken.

For maximum munching, drop by on weekends when the store's really crowded. The sample servers will be so busy they won't even notice that you're making your second--or is it your third?--pass through the freebie line.

Readers' Choice: Price Club

BEST HARDWARE STORE

Co-op

1821 East Jackson

(and other Valley locations)

253-2516

Franchising is king in the hardware business, where nearly every store is either an Ace or a True Value dealer. And these stores are useful, if you don't mind buying nuts and bolts by the prepackaged dozen. But there is an alternative, one that's tucked away in a nondescript industrial enclave east of downtown.

At the Co-op, acres of loose nuts, bolts and screws are surrounded by tools and building materials of every description. And that's just the first building.

There are four, each the length of a football field, housing building materials, hardware, garden supplies, pet goods, feed, even sporting goods. And everything looks like it's been the same way forever.

A typically laid-back, friendly staffer tells us that the Co-op was founded by turn-of-the-century farmers who each bought in for 50 cents to benefit from buying in bulk. The more the farmers bought, the more shares in the cooperative they collected, and the more dividends they were paid later from what the co-op profited.

Today, you don't have to be a farmer to shop at the Co-op. But the price of becoming a member may transport you back to territorial days. Miraculously, it's still just 50 cents to join.

Readers' Choice: Home Depot

BEST HARDWARE STORE FOR IDIOTS

Koller True Value Hardware

6016 North 16th Street

274-9722

We heard a rumor once that there are two different kinds of screwdrivers, but we never checked it out. So you won't be surprised to learn that we freak out in those so-called superstores, where the clerks bully you if you don't have an engineering degree. We feel much better at Koller, which carries all the essentials, but keeps that old-fashioned corner-store touch. We particularly like the ancient gumball machine on the counter and the incongruous display of fake owls.

A couple of Generation Xers slouch behind the counter, listening to alt. rock, but they come to life when a customer approaches--and know what they're doing without feeling the need to wow 'em with big words and bigger tools.

"Good luck--I hope you don't need it," one clerk calls as a guy leaves with a shower head, fully briefed. The clerk even stops the customer to remind him of the name of another store where he can get help with some remodeling.

Makes us feel so good, we may ask about those screwdrivers, after all.

BEST MILITARY SURPLUS

Larada's Army Surplus

764 West Main, Mesa

834-7047

When we called directory assistance for Larada's phone number, the operator chuckled, and asked conspiratorially, "Don't you love that place?" Yes, we do.

We can't walk into Larada's without at least momentarily suspecting our life thus far has been naught but a derelict waste and that what we really need is to find a militia group. Everything the angry middle-aged white guy needs to turn his home into a bunker is here, compliments of too-fat U.S. government contracts and other sources.

But before the Viper vision takes over completely, we usually remember that we're not all that angry and we turn instead to the terrific and inexpensive camping gear at Larada's, which is housed in a blocky building painted eye-catching yellow. Ah, nature!

Besides the usual leftover goods made for our troops, there's plenty of great new stuff, too. Like stoves and mess kits and sleeping bags. Go upstairs and check out the tent room--that's also where you can find pieces of hospital foam, the mattress of choice for car campers fed up with blow-up beds. And don't miss the full selection of clothing, just in case you were thinking of masquerading as a '50s jet pilot or a WWII infantryman for Halloween this year.

Unlike some surplus stores that go heavy on the surly, vets-only aura, Larada's won't make you feel compelled to salute to get in the door. Sure, you can stock up on "America--Love It or Leave It" bumper stickers, but there's enough nonmilitary stuff and good-natured help from the staff to make even the most pacifist backpacker feel welcome.

BEST KITCHEN GADGETS

Scottsdale Kitchen Company

Fashion Square

Scottsdale Road and Camelback, Scottsdale

990-9123

This small, octagon-shaped shop is crammed with kitchen accessories. Need to slice a bagel without losing a finger? There are several solutions to that timeless problem. Want to make your own tortillas? Shake, not stir, your own martini? Bake your own sourdough bread? For every culinary challenge, there's a device, shortcut or power tool.

And for those obsessed with owning every kitchen gadget Martha Stewart owns, there are even color-coded vegetable brushes--the brown ones for cleaning off potatoes, the orange ones for carrots, the green ones--well, you get the idea.

Sure, some of the stuff is silly. But all of the more serious items are here, too, for the discerning gourmet: fine knives, copper pots and more exotic cookware. And, thankfully, you can peruse these gourmet items without the snootiness that so often goes with fancy cooking. The staff is down-to-earth and friendly, and seems as happy answering questions about the best way to make popcorn as how to assemble paella.

BEST CHAIN BOOKSTORE

Borders Books & Music

Biltmore Fashion Park

24th Street and Camelback

(and 1363 South Alma School, Mesa)

957-6660

Some people dream of being locked in a bakery shop overnight. Us? We fantasize about tossing a slumber party at Borders.

The bash will kick off in the store's world-class newsstand, with guests madly thumbing through magazines in an effort to find the most astonishing factoid or most unflattering paparazzi shot. Next, we'll move into the gigantic fiction section where partygoers will read aloud favorite passages from such literary classics as Lady Chatterley's Lover, The Tropic of Cancer and Valley of the Dolls.

Following a midnight snack at the upstairs espresso bar, our nocturnal bibliophiles will set out on an in-store scavenger hunt, seeking out a variety of hard-to-find books, CDs and videos. Not surprisingly, the game ends in a tie when all teams find every single item on their lists.

As dawn breaks over the wondrous store, weary revelers carefully reshelf every book in its proper place. Then we freeze someone's bra.

Readers' Choice for Chain Bookstore and Kids' Bookstore: Borders Books & Music

BEST CHRISTIAN BOOKSTORE

Berean Christian Stores

3434 West Greenway Road

843-2200

Bibles, posters, games, stationery, CDs, videotapes, sheet music, toys, costumes, knickknacks, comic books, artwork, candy, even Christian office supplies, whew! With its ungodly inventory of inspirational merchandise, Berean Christian Stores easily crucifies the competition.

Think of it as Jesus Christ's superstore.

BEST WESTERN BOOKSTORE

Scottsdale Book Sellers

7134 East Main, Scottsdale

946-0022

Rare-book collector T.A. Swinford has transformed his passion for mostly rare, mostly out-of-print books on the American West into this charming, homespun business.

Swinford's store is a labyrinthine series of rooms housing thousands of rare tomes about the American West. The collections are vast and impressive and include everything from libraries of unusual Indian books to reams of military documents to '50s-style Roy Rogers kitsch volumes to books about outlaws, both famous and obscure.

Swinford himself claims he doesn't know how many books he owns, but every so often he publishes catalogues listing thousands of new acquisitions for collectors, students, libraries and Old West buffs.

He even has a back room with locked iron doors (looking very much as though they came from a Western-movie set) where he stores his extremely valuable books. He won't say how much they are worth.

But an American West buff doesn't have to spend a fortune at T.A. Swinford's--many books are priced in the $15 to $35 range.

We've found that even folks who say they have little or no interest in the American West end up finding some obscure topic that interests them. So saddle up and head on over.

Readers' Choice: Changing Hands Bookstore, Bookstar and Bookman's (tie)

BEST SINGLE-TOPIC BOOKSTORE

Obelisk Bookstore

24 West Camelback

266-2665

Don't ask? Don't tell?

Then don't bother with this welcome addition to the local literary scene, believed to be the state's only exclusively gay-and-lesbian bookstore.

A well-stocked shop that could hold its own against similar stores in San Francisco, West Hollywood and Greenwich Village, Obelisk carries an impressive selection of fiction and magazines and newspapers covering the full spectrum of gay life. Sexual politics, coming out, AIDS, recovery, "she-rotica"--it's all here.

So are the collected works of everyone from Camille Paglia and Armistead Maupin to RuPaul and Tom of Finland. (Don't know who that last one is? Ask--we'll never tell.)

BEST ONE-STOP COOL-STUFF BOOKSTORE

Reid's Books

1250 East Apache, Tempe

894-3329

Not everybody out there is fighting for a place in line to buy the latest "book" by John Grisham or Anne Rice, and for those whose tastes run in a direction that does not include making writers of pabulum into millionaires, Reid's may be your place to shop.

Open only since February, the place specializes in offbeat pop-culture material--books, mags, 'zines, albums--and while some of this stuff has reached the mainstream shores of Tower and Borders, you'd be hard-pressed to find such a broad and distinctive selection under one roof.

Curious Punishments of Bygone Days, Interrogation Techniques and Death Scenes are fast movers, right along with Pat Conroy and Charles Dickens. And dig that wall of magazines: Angry Thoreauan (loaded with punk satire), Hollywood Highball, Anamato! (Japanese animation stuff) to name but a few, and comics like Acid Boy, Yikes and Eightball.

But not everything is hip; thinking folks will find a solid foundation of works in the film, mystery, true crime and, yes, philosophy sections. Best of all, standing in the store for lengthy periods is not only allowed but encouraged. Provided your body odor is not too awful, and there is a book in your hands.

BEST PLACE TO GET OUT-OF-PRINT BOOKS

Changing Hands Bookstore

414 South Mill, Tempe

966-0203

You are a serious bibliophile for whom literature is sustenance. To you, a visit to a good bookstore is like a stroll through a well-stocked deli. You crave exotic fare that goes beyond the staples of coffee-table books, bodice rippers and thrillers.

Changing Hands Bookstore is the place for you. The Mill Avenue shop specializing in both new and used books has become a Valley institution, and for good reason. Spread out over three floors, the store's hushed, homey surroundings are the ideal place to browse and leaf through any of the 50,000 titles lining the shelves. If you feel overwhelmed, the shop's knowledgeable staff can point you in the right direction.

Ever wonder what your favorite author's prose looked like before the editors finished with it? Then swing by Changing Hands' recently added out-of-print and collectibles section and you might just luck out. This area features a handful of hard-to-find advance copies, known as "uncorrected proofs" in the publishing biz. You'll also find dozens of rare first editions and other collectibles.

If you're on a budget, check out the basement, which brims with everything from newer best sellers to older, obscure volumes. If you still can't track down that tome, Changing Hands does used-book searches for $2.50.

Bon appetit!

BEST COMIC-BOOK STORE

All About Books & Comics

517 East Camelback

277-0757

If we were comic-book artists, we'd be drawing a blank right about now. A big blank. Think of a huge cartoon speech balloon with nothing in it and, well, you get the picture.

Yep, we're finally speechless.

What could we possibly say about this flagship fortress of funny books that we haven't told you umpteen times in the past? That this citadel of comics has been sweeping this category since Krypton exploded? That this bastion of superheroics is a great place to get in touch with your inner Superboy? That anyone who's remotely interested in comic-book culture would have to be a Bizarro not to already know about it?

#+
@!!!End of this panel discussion.

Readers' Choice: Atomic Comics

BEST PLACE TO HEAR A GOOD BOOK

Redding's Bestseller Audiobooks

2335 East Camelback

955-6210

It was on the long road to Cave Creek. At stoplights, our fingers ran up and down the radio buttons from alternative to oldies to static to NPR. Nah. We fast-forwarded through Beck to get to "Loser," went past it, changed tapes. Did the macarena with the Bayside Boys and almost wound up in an irrigation ditch. The three-minute pop song was driving us to desperation. We needed new drive-audio.

Then, one day, our buddy Dave said listen up and headed us to Redding's--where the reader meets the road.

Here we found more than 10,000 literary audio titles for sale or rent, including classics, current best sellers, biographies, fiction, nonfiction, self-help and a dozen more categories. Just before our last drive to Flagstaff, we

rented both Restoration, exquisitely read by Derek Jacobi, and Maynard, Gilligan and Me, stirringly read by the author, Bob Denver himself.

The average cost is $3.99 for each three-day rental, plus a one-time $10 membership fee.

BEST VIDEO RENTAL STORE

Tower Video

Tempe Center

Mill and University, Tempe

968-7774

The crown jewel in a stellar chain, Tower's Tempe outlet is nothing short of a couch potato's own private Idaho. Thanks to its proximity to ASU and the Mill Avenue cognoscenti, this outlet boasts a wider--and quirkier--spectrum of titles than you'll find anywhere in town.

All the usual suspects are here, as well as scads of classics, special-interest tapes and--duh--music videos. Looking for ethnic diversity? The foreign section alone carries some 500 subtitled pics. And the Midnight Movie nook is stocked with enough celluloid catnip to keep insomniacs of kitschier taste up late for a year.

Readers' Choice: Blockbuster Video

BEST CELLULOID CLOSET

Movies on Central

4700 North Central

274-0994

The cinema that dares not speak its name is alive and well at Movies on Central.

But don't rip up your Blockbuster card just yet; the mainstream selection at this gay-oriented video boutique is hardly worth mentioning.

The big attraction here? The back room--home of such whacked-out spectacles as Curse of the Queerwolf, Let Me Die a Woman! and No Skin Off My Ass. More sober-minded viewers, meanwhile, may opt for a Stonewall documentary, a transvestite training video or dawn-of-liberation soft porn like Pink Narcissus.

Still can't decide what to rent?

Check out the fascinating Homo Promo, a compilation of trailers from gay-themed Hollywood pix like Tea and Sympathy and The Children's Hour--many of which are also available for rental in their entirety.

When you drop by, tell 'em that Edina and Patsy sent you.

BEST PLACE TO BUY VIDEOS

Suncoast Motion Pictures

Metrocenter, between Dunlap and Peoria off I-17

(and other Valley locations)

943-0299

In real estate, it's location, location, location. In this category, it's selection, selection, selection--Suncoast has more titles than you can shake a remote control at.

The only video chain in the Valley specializing solely in sales, Suncoast doesn't take its unique market niche lightly. If a title's on video, chances are it either will be on the shelf or (in the case of more obscure titles) available through special order. And don't forget to check the big array of budget titles, a rotating hodgepodge of $9.99 flicks ranging from Taxi Driver to Bad Girls From Mars.

BEST PLACE TO RENT BUDGET VIDEOS

Video Update

Squaw Peak Promenade

16th Street and Glendale Avenue, Phoenix

(and other Valley locations)

678-1284

Okay, so midweek video-rental specials are a dime a dozen. But for our money, no one's doing it cheaper--and with a better selection of titles--than Video Update.

On Tuesdays, all new releases are just 99 cents a night. So far, so good.

But it gets better. Also on Tuesdays, the rental rate on every "catalogue" title (i.e., non-new releases) is two for 99 cents, and--here's the great part--those tapes don't have to be returned until Saturday!

According to our calculations, that brings your cost-per-rental down to somewhere in the neighborhood of 12 cents a night. Cheap thrills--they don't come much less expensive than this.

BEST CROSS-MARKETING CONCEPT

Chandler Liquors

554 North Arizona Avenue, Chandler

963-5100

In one of the few parts of Chandler that doesn't look like it was built last week, we know of a great little place where you can pick up everything you need for the perfect desert shoot-out.

But that's obvious if you've ever driven past it. On the weather-vanelike old sign above the roof is the store's name, Chandler Liquors. Below that, in big black letters against a yellow background:

Guns * Ammo * Picnic Supplies.

That's right, you can buy a gun, an armory of bullets, a tablecloth, bug spray, food, a case of beer and a few fifths of your favorite rotgut all in one trip. Once you start emptying those beer cans, you got yourself some handy targets, too.

Chandler Liquors isn't shy about mixing its two most volatile products. Long rifles and shotguns hang over jugs of Wild Turkey and Early Times, and the handgun display case is right up at the front of the store. The pistols are inexpensive .25- and .22-caliber semiautos, derringers, a 9mm--all brand new, the clerk says. There are few brand names.

As picnickers-marksmen sidle in, they hunch near the case to get a closer look at the snub-nosed pieces of metal. They mull over things like reliability, stopping power, how easy it would be to conceal, and other concerns of thoughtful gun buyers.

Then they decide what they're thirsty for.

BEST PLACE FOR A VIPER MILITIA SHOPPING SPREE

Price Club

4502 East Oak

(and other Valley locations)

808-0116

Just because the Cold War is over, don't think we've necessarily sidestepped Armageddon. Ever watched The X-Files? Ever been to Montana? Peoria? Better play it safe, stock up--the denouement could last a long, long time. And that, precisely, is the beauty of having this great buy-it-by-the-gross citadel in our midst.

Here, with minimal effort, you can amass cartons of individually sealed chocolate pudding snacks, five-pound cans of Spanish peanuts or gazillions of headache tabs for those stressful bunker days ahead. Load up on dozens of batteries to power your portable TV and swamp cooler when SRP and APS pull the plug, and pick up cases of toilet paper for when . . .

You get the idea. And the Price Club formula for high quantity/low price makes it all possible. The price of liberty? Bulk-buying.

BEST BIRDS

Way Out West Bird Expo

Arizona State Fairgrounds

1826 West McDowell

Billed as the largest bird mart in Arizona, and one of the largest in the country, the biannual Way Out West Bird Expo is what its name implies: strictly for the birds. The one-day events, held both in spring and fall, feature more than 300 vendors of more varieties than we'd seen in a year of haunting local pet shops.

Here you'll find flocks of baby birds raised by competent fanciers who--on the spot--advise you on their proper care and feeding. That perfect baby African Grey, lovebird, macaw or cockatiel you've been searching for? Peep, here it is!

And don't miss the incredible bargains on all sorts of birdcages. Everything from single-occupancy to planned-community aviaries that humans can walk into sell at less than half the normal retail prices. And nesting boxes, ladders, feeders, bird toys made from organic materials or Day-Glo Lucite are nearly a steal here.

It's a great deal both for you and your fine-feathered friends.

BEST PLACE TO SHOP FOR GROCERIES ONLINE OR BY FAX

Bashas'

3131 East Indian School

(and other Valley locations)

956-2010

Does the crank-jag bustle of the supermarket make you feel like stealing coffee creamer from work to eliminate that postworkday pit stop for a carton of milk? Then leave the great linoleum jungle behind. Bashas' has the solution--tele-groceries. We picked up a grocery catalogue at the store's entrance and that was the last time we set foot in the place.

Now we simply slip in front of our computer with a cup of tea and get online. Virtually browsing through the bakery, deli and dairy departments and every aisle, we select our groceries and place our order--either online or via fax. The delivery arrives promptly the same day or next day, depending on when we order.

Prices are the same as in the store, even on sale items. And when we request stuff that isn't in the catalogue--like low-fat Pop Tarts--Bashas' accommodates if the product's in stock. Best of all, our personal shoppers select good, fresh produce--and they even throw in those little Bargain Booster stamps.

BEST CIGAR SHOP

Tinder Box Internationale

Fiesta Village

1312 West Southern, Mesa

644-9300

Bill Cosby does it. So did George Burns. JFK did it often, probably in the White House while his children were watching.

Smoke cigars, that is. And now, stogies are enjoying a renewed popularity, especially on Phoenix golf courses, we notice. There's just something about hitting a dimpled ball with a stick that makes you feel like taking a five-and-a-half-inch Corona in hand and lighting up.

But the local stogie story really begins at Tinder Box Internationale, where implements of cigardom stare from within glass cases and fine wooden display shelves, including those miniguillotines for clipping your Macanudo just so.

The friendly, knowledgeable owners know a good trend when they see it, but they're no mere pretenders: They'll explain, for instance, why one lighter is better than another for igniting a given cigar.

If you're feeling particularly Churchill-like, you can shell out $450 and join Club Amante, which entitles you and fellow club members to hang out in a private smoke-filled room where you can play cards, backgammon or chess, watch the U.S. Open on a big-screen TV and keep your stash in your own personal locker.

It's a smokin' deal.

BEST GLITZ

Accente

Fashion Square

Scottsdale Road and Camelback,

Scottsdale

970-0007

Hardly an item passes through the doors of Accente without sequins, nailheads or beading attached to it, and the earrings could double as wall hangings when you're not wearing them.

We are especially fond of the "Lunch at the Ritz" costume-jewelry collection. One-of-a-kind, or at least very few, pieces at about $150 and up, they are witty depictions of everything from penguins to motorcycles. We understand one customer owns upward of 100 examples.

BEST PLACE TO BUY JEWELRY WHEN PRICE IS NO OBJECT

Capriccio at the Borgata

6166 North Scottsdale Road, Scottsdale

948-4708

Recently, we have found new inspiration to try to win the Powerball jackpot: Capriccio at the Borgata. We're talking serious motivation to invest in lottery tix. The display of diamonds and other gemstones there can turn knees to gravy and push pulses way into triple digits. Every possible arrangement for attaching diamonds to the human frame is on show with the possible exception of a pave Juliet girdle, and if that's your style, Capriccio can make one up for you.

Custom pieces by the ingenious young designer Shirley Johnson are crafted using Capriccio gems or, if you happen to have a kitchen drawer full of loose diamonds, using your own. You will not, dahling, see yourself coming and going in Shirley's designs.

BEST PLACE TO BUY DIAMONDS FOR PEOPLE WHO READ PRICE TAGS

London Gold Direct Diamond Importers

6070 West Bell, Glendale

(and other Valley locations)

843-2293

It's fun to go anywhere and window shop for diamonds, but if you want to make an informed purchase at the best price, check out London Gold Direct Diamond Importers.

The manager of the Glendale store not only taught us the basics of what to look for when buying a diamond, he also encouraged us to shop around and ask the tough questions. All dealers, he told us, purchase diamonds on the basis of cut, carat, color and clarity. But how many stores bother to inform you of those important variables in determining quality and cost?

London Gold records the grades for cut, carat, color and clarity right on the receipt. That way, later, if you ever need to use your loss-or-damage warranty, you can be sure that the replacement will match the quality of the original.

With a promise to beat any competitor's price quote by at least 5 percent, London Gold Direct Diamond Importers lives up to its motto:

"Always better than a sale!"

Readers' Choice for Fine Jewelry: London Gold Direct Diamond Importers

BEST PLACE TO DRINK COFFEE AND MAKE STUFF

Made of Mud

7119 East Sixth Avenue, Scottsdale

941-4330

Okay, so it wasn't coffee that gave Toulouse his inspiration at the Moulin Rouge. But it can be yours at Made of Mud. The paint-it-yourself pottery studio and espresso bar lets you design and decorate your own mug, vase, bowl, candlestick or other piece while you happily slurp your cappuccino. But you might want to trade the caffeine jolt for an Italian soda--it keeps the hand steadier on that paintbrush.

Here's what you do. First, pick a piece of pottery. Pieces cost $2 to $30, with most mugs in the $6 to $9 range. Then choose up to five colors of ceramic paint--don't choose the same colors as your friends, since you can share. Then grab a brush and create your masterpiece. Charges are by the hour: $6 for the first hour; additional hours are prorated in 15-minute blocks. When you're through painting, apply two coats of glaze, leave your creation to be fired and return in three days to pick it up. Voil ! Art!

Open Tuesday through Thursday 11 a.m. to 9 p.m.; Friday and Saturday 11 a.m. to 11 p.m.; and Sunday noon to 5 p.m.

BEST PLACE TO BUY A WEDDING GOWN

Azteca Plaza Bridals and Formals

1010 East Washington

253-2171

We have specialized more in being a bridesmaid than in being a bride. Nonetheless, we know something about brides. For one thing, they're not all size 10, the stock try-on size at most bridal shops. A frequent wedding-dress scenario: teeny-weenie size-3 brides tripping on too-generous lengths of tulle or chiffon piled at their feet. Conversely, larger-size brides have to use their imaginations, since they have a better chance of fitting into Cinderella's slipper than a size-10 dress. Azteca understands.

The store stocks thousands of dresses for brides and bridesmaids in a range of sizes, so, no matter her dimensions, a woman can try on dresses until she finds her destiny. Azteca's prices are good, too, and if a woman has seen a dress she likes that isn't stocked in her size, it usually can be ordered.

In the same plaza, brides-to-be can finish most of their wedding shopping. Flowers, invitations, tuxedos, dress clothes for kids and, for a quick pick-me-up, even a homestyle-Mexican restaurant are all available in the Azteca Plaza. Azteca is open Monday through Friday noon to 8 p.m.; and Saturday 9 a.m. to 5 p.m.

BEST PLACE TO SELL YOUR WEDDING GOWN

My Sister's Closet

Town & Country Shopping Center

20th Street and Camelback

954-6080

We know the story. You found the perfect dress. You tried it on, even though you knew it cost way too much. Everything was perfect: The fabric. The train. The sleeves. So you bought it and looked beautiful in it. Now, the big day is over. That blissful walk down the aisle is naught but a memory. And MasterCard wants you to pay for the dress.

My Sister's Closet can help. It has a special room for brides' gowns, veils and shoes. These postnuptial specialists will take your dress on consignment for up to six months, splitting the take with you when it sells. Prices generally start at about one third of the original price of the dress, with gradual markdowns if there are no takers. You always have the option of taking the dress out of consignment if you think the price is getting too low--or if you think you may need it again.

BEST BRIDAL REGISTRY SHOPPING

Target

740 West Camelback

(and other Valley locations)

263-6035

Yep--more proof that computers are taking over--but they do such good work! To select a wedding gift at Target, all you need to do is find the computerized Club Wed kiosk near the customer-service desk--and do it yourself. No snippy clerk, no waiting in line. The computer asks the questions and you touch its screen to answer: First three letters of the bride or groom's last name? First two letters of the first name? Choose the region of the country where the wedding will be, then the state.

Promptly, the computer searches its database of the betrothed and spits out the couple's names and the wedding date. You can examine their registry on screen or, in minutes, receive a printed list in hand. Then, simply decide on a gift, find it and take it to the check-out. Oh, yeah, then pay for it. Ouch.

BEST PLACE TO RENT A HALLOWEEN COSTUME

Mardi Gras Costume Rentals

5895 North Granite Reef, Scottsdale

948-4030

The main difference between L.A. and Phoenix is that you can tell when it's Halloween here. Unlike the typical Angeleno's closet, ours are prudently outfitted with lightweight, loose-weave provisions that look, well, normal. The bright-colored brocades of the Renaissance, for instance, wouldn't be practical here. Maybe that's why Phoenicians like Halloween parties--we get invited to a slew of them. It's our special time to break out of the khaki and denim.

For sheer volume and variety, escape the mundane at Mardi Gras Costume Rentals. With its thousands of costumes in stock, you can be a Renaissance princess or Amelia Earhart, a court jester, a Star Trek character, a flapper, a '40s starlet or General George S. Patton. Pick your fantasy.

Costumes come in sizes to fit most kids and adults, and Mardi Gras sells theatrical makeup, wigs, beards and mustaches to complete your look. Open Monday through Saturday 10:30 a.m. to 5:30 p.m., with extended hours before Halloween, starting October 1.

BEST MANICURE

Mood Swings

520 South Mill, Tempe

968-0268

Darn that snag!

When those nasty hangnails, runaway cuticles and brittle, cracking ridges get us down, we hand ourselves over to Mood Swings. This innovative salon in Old Town Tempe employs two nail technicians who put the "cure" in manicure.

Manicures here start as most, basic filing followed by soaking each paw in hot oil. Next, the technicians hone in on our cuticles doing what we consider the best cuticle work in the Valley (we did not get a hangnail for more than a week). After that, the mood-altering portion of the process occurs.

These manicurists extend the minimassages typical of most manicures into facials, more or less, for the forearms and hands. They apply and work into our skin at least six preparations with highly rejuvenating properties. A stimulating massage for our hands and forearms followed by a soothing hot-towel wrap lifts our spirits up and away from our digital doldrums.

All done, we scintillate from elbows to our well-tailored talons.

Our snaps go to Mood Swings.

BEST HEAD SHOP

The Headquarters

125 East Seventh Street, Tempe

966-6093

Talk about one-stop shopping. The Headquarters carries everything associated with the stoner lifestyle except the "herbal tobacco mix" itself (words such as "pot," "ganja," "yesca" and "green bud" will get you tossed from any Arizona head shop).

Blunts. Seedless-brand hemp clothing. Oversize posters. Door beads ($29). Body jewelry. System flush kits to beat a piss test. Nag Champa incense in bulk (100 gram/$7.95; 250 gram/$18.95). Wood pipes. Antler pipes. Exquisite handblown glass pipes ($40). Triple-chambered bubble bongs that change color when you smoke through them ($50 to $70). Grandaddy Graffix bongs, with six-foot chambers ($64). Word up--The Headquarters has a knack for small details--all bong purchases come with six screens and a poker.

We like this head shop as much for what it doesn't sell as for what it does. We don't like tweakers, and we don't like tweaker head shops. We don't like buzz-kill clerks who make it a policy to scream a greeting at every customer as he or she comes in the store. We appreciate The Headquarters' lack of "eucalyptus inhaler" crack pipes and "snuff tobacco" razor/mirror kits.

We don't care much either way about the Carlos Santana/Phish/Dave Matthews Band heavy shopping tunes, but we definitely give a thumbs up to Hendrix, the unofficial canine HQ mascot, and the cosmic guilt-trip antishoplifting signs. Our favorite: "The HQ proudly wishes bad karma on anyone who is lame enough to steal."

BEST PLACE TO BUY A FAKE CHRISTMAS TREE

Paddock Pools and Spas

6525 East Thomas, Scottsdale

(and other Valley locations)

947-7261

In October, November or December, only the hardiest of our city's polar bears willingly stick their little piggies into the backyard swimming pool. Consequently, there isn't much call for extra chlorine tabs, Power Ranger water wings and the other supplies down at your neighborhood pool-supply store.

Maybe that's why at Paddock Pools' retail stores, 'tis the season when above-ground spas, patio sets and pricey barbecue grills take a back seat to the best stand of faux firs and simulated spruces in town.

Sure, browsing Paddock's indoor forest is not quite like bundling up and heading out to your corner tree lot, and the unmistakable aroma of chlorine does hang thick in the air, but the selection is out of sight and the coffee's hot. We found more than 50 varieties, most of which looked suspiciously real. And, for that just-cut aroma, some even came complete with a scented oil for spritzing. You do pay a price for the political correctness of packing your tree away rather than pitching it on the curb. Paddock's pines range from $89 to $700 each.

BEST BODY-PIERCING SALON

HTC Body Piercing

808 South Ash, Tempe

784-4460

We chickened out at the last minute.

It wasn't the prices--for 20 bucks, we could have had our navel, nipple, brow, tragus (look it up) or nostril pierced, for 25 our tongue, septum or genitals (HTC is the only piercing salon in the Valley to work below the waist).

And it wasn't the employees, who were cheerful, informative, patient, surprisingly normal in appearance and who repeatedly promised to be gentle with us our first time.

And it wasn't the atmosphere--the interior of HTC Body Piercing is clean as your doctor's office, and the boldly posted "Piercee's Bill of Rights" is designed to put the mind at ease if not the body, guaranteeing sterile conditions, a new needle for each pierce, sober piercers (sounds silly, but think about it) and a thorough post-op debriefing.

No, it was the sign that did it. The one tacked to the wall eye level across from the door to each of HTC's piercing rooms that says "STOP if you feel lightheaded. Please sit down in the waiting area and let one of us know." That planted a seed of doubt that quickly grew into a tree of anxiety that not even the Gregorian chant CD playing in the background could soothe.

But we are weak and you are strong--you desire the feel of metal puncturing your flesh, you relish it. You long to settle into one of the piercing chairs in HTC's private rooms, which look like a dentist's office cross-dressing as an S&M chamber, and brace yourself for the endorphin rush. Ohhhh, it hurts so good.

BEST PLACE TO GET PAMPERED

The Spa at Marriott's Camelback Inn

5402 East Lincoln Drive, Paradise Valley

596-7040

The list of those who have been oiled, herbed, loofaed, hosed, steamed, mud-packed, massaged and packed in seaweed at the Spa at Marriott's Camelback Inn is about as impressive as its roster of pampering services.

George and Barbara? Been there. Oprah and Waylon? Done that. As have Tommy Tune, Mary Tyler Moore, Kim Alexis, Reba McEntire, George Hamilton, Jane Seymour, Victoria Principal, Sharon Stone. Well, you get the picture.

Unlike most star-studded pamper palaces, though, this spa has a y'all come attitude toward those of us who rank among the Valley's great unwashed. Pamper packages start as low as $85 for a half-hour massage and an herbal wrap, including the full day's use of the spa, making it a must for Mother's Day or other special occasion when pampering will earn the gift giver major Brownie points.

The place itself is pretty spectacular, covering 27,000 square feet at the base of Mummy Mountain in Paradise Valley. On a clear day, you can even see downtown Phoenix from one of the spa's 16 indoor and outdoor massage rooms--perfect for those who would be wondering about the poor slobs back at the office.

BEST BLACK-HAIR SALON

New York's Cut and Style's

519 East Eva

944-0737

Sistahs of Arizona, your prayers have been answered and her name is Cheryl L. Shipman, owner and head stylist of New York's Cut and Style's. With Ms. Anne, her assistant and mother-in-law, Cheryl (a New York native, natch) has been beautifying Phoenix women for the past five years.

A steady clientele of Suns wives, Cardinals wives, ASU students, doctors and lawyers enjoys her head-turning talents which range from wraps to wet sets to ponytails and constructing up-dos and French rolls of all shapes and sizes. But her passion lies in haircuts.

You can walk into her cozy, laid-back salon with no more than a magazine picture of a hairdo and walk out with the picture realized en coif. If you are indecisive or you don't know what's best for you, girlfriend will take one look at you and hook you right on up.

The end product is tops, but the pampering process runs a close second. Ms. Anne invites you into her work station where she proceeds to wash your hair, an endeavor that is the massage-therapy equivalent of Prozac. Ms. Anne's delicate but firm touch could slay dragons. You may find yourself asking for a second wash. After a brief meditation at the washbowl, it's off to Cheryl for the regal treatments discussed above. The result is a Nubian mane that has been primped with all the love and care that this team has to offer.

BEST SALON FOR THE "NEWS ANCHOR" LOOK

Rolf's

4722 North 24th Street

468-8288

So, what's your pleasure? Short and perky like Patti's, sexy and provocative like Jineane's or darling like Darya's? Regardless of which local news team strikes your fancy, your search is over for the area's No. 1 specialist at the coveted "anchor bob." The place where you'll likely find the Valley's best-tressed broadcasters is in the beauty basins at Rolf's.

Since it opened in 1988, Rolf's has become the haven for high-profile coiffures. In addition to Channel 3's Patti Kirkpatrick, 12's Jineane Ford and 15's Darya Folsom, co-owners Rolf Lohse and Pat Petznick, and their

crew of nearly 70, service a heady roster of news types. Their client list includes June Thomson, Catherine Anaya, Lisa Taranto, Sean McLaughlin, Kent Dana, Mark Curtis, Lin Sue Shepherd and a host of others, making it the top shop for Phoenix TV's town criers.

"They really know what's hip and what's in style. Everything they do, from hair to nails, they do well," says Taranto. "I feel like I'm loaded when I walk in. They treat you like a star."

A word of warning: If you're having a bad-hair day, don't expect immediate help from Rolf and Company. Appointments book at least two weeks out; and the wait is six to eight weeks if you're hoping for the handiwork of Rolf himself.

BEST FANCY DOG GROOMER

Bark 'n' Babies

8989 East Via Linda, Scottsdale

860-2224

There are two points of view from which to judge a dog groomer--yours and the dog's. We have counted heavily on body language in assessing the opinions of the dogs and can report that their moods at Bark 'n' Babies ranged from eager to get there to been there, done that. The eagerness may be because of the little dish of doggie treats on the counter, but these are animals accustomed to indulgence--we doubt that their loyalties are won so cheaply.

Owners were easier to interpret. The ones we talked to have standing appointments for their pets for a full range of beauty treatments, from a straightforward wash all the way up to elaborate clips and pedicures. They clearly love the range of services. With your eyes shut, a conversation between owner and groomer could easily be mistaken for one between a woman and her own hairdresser.

We put B 'n' B to the test ourselves with the help of our favorite canine subject--an independent-minded, large mixed breed greatly given to swamp romping. She emerged looking and smelling like a dog ready to pose with an Infanta for a Velazquez portrait and clearly tickled pink with herself. We told her, "Don't get used to it."

BEST PET STUFF

PetsMart

1315 West Elliot, Tempe

(and other Valley locations)

961-9700

Sometimes, bigger is better. Giant chain stores provide dizzying selections and good prices. At PetsMart, that means pet stuff for just about any varmint that flies, swims, crawls or sheds all over your couch just before the in-laws show up.

Such McStores tend to hire vacant McTeenagers and at PetsMart that makes for slow check-out lines. But that's okay, the real draw is the entertainment: other people's pets.

PetsMart is the only store where you'll see nearly as many dogs as humans shopping. The dogs strain at their leashes like eager bargain hunters. With linoleum floors (for obvious reasons), the place was built with pets in mind. And the smells in the place can really blow a puppy's mind.

Readers' Choice: PetsMart

BEST HOMEMADE DOG TREATS

Puppy Gourmet Bakery

554 West Third Street, Mesa

969-9505

Chances are you'll appreciate these dog delicacies more than Fido (really, does the dog care if the treat is shaped like a fire hydrant or a star?), but our own pup was quite pleased with the Puppy Gourmet Bakery's biscuits. Owner Cami Finger says she consulted with veterinarians in formulating her all-natural but good-tasting treats.

Our taste tester was particularly partial to the peanut butter and "barkaque ribs" (get it?) biscuits, and we couldn't bear to offer up the "gourmet tootsie pop"--a peanut butter and carob biscuit swirled and stuck on a chew stick.

Cami Finger insists her biscuits are healthful, but, she warns, like any low-fat human food (e.g., low-fat brownies and potato chips), too much of a good thing will make Fido a fatso.

BEST STRIP MALL FOR THE YOUNG, HIP AND FINANCIALLY GIFTED

Apache Dorsey Complex

1250 East Apache, Tempe

If you're driving along Apache Boulevard at 50 miles an hour, this place looks like just another drab, character-free strip mall taking up space in the desert. In fact, if you were to turn your head even enough to catch a peripheral glance at this blocklong stretch of businesses, you'd probably think to yourself something like, "Well, there's another drab, character-free strip mall taking up space in the desert."

Ah, but how wrong you would be!

For if you were to take the time to slow down, maybe enter the parking lot, step from your vehicle, take a deep breath and slowly take in what this mall has to offer, you would see that it is anything but a drab, character-free strip mall, blah, blah, blah.

Start at the western end with O'Malley's. That's right, it's a bar. A sports bar, to be exact, and while there's nothing too remarkable about that, at least it serves alcohol. After a few drinks, what better thing than to get a tattoo? Get the job done right next door at Mom's Tattoo.

You're buzzed and in pain; head to Reid's Books, a tremendously cool, highly browsable shop stocked with plenty of oddball mags, legitimate international newspapers, and new and used books with an accent on pop culture (that includes sex and occult sections, kids!). Onward to noble and necessary Planned Parenthood, then rid yourself of dirty laundry in style at White Water Oasis (it's got a wide-screen TV and a pool table).

While your shorts are drying, perhaps you should consider a new career at the Bartending Academy ("Where the Fun Jobs Are"--now that's a slogan). Did someone mention rock? Full speed ahead to Stinkweeds, where all forms of alternative music thrive on CD and vinyl, plus you can buy Snapple from the see-through refrigerator and sip while you shop.

Of course you're hungry by now, so fill up at Pita Jungle, where the food is healthful, cheap and amazingly tasty. If McDonald's meals are happy, at PJ they are ecstatic. If you slipped in a puddle from the misters, get that

wrenched skeleton back into place at Chiro Works. Then top it all off with a wonderful bit of Middle Eastern cuisine at a place that has a sign that doesn't lie, Tasty Kabob.

Oh, and on your way back to the car, drop by Filiberto's (open 24 hours, it's the constant heartbeat of this little mall that can) and bring some sensual, sloppy Mexican food home. Then come back tomorrow and do it all in the opposite direction.

BEST PLACE TO GET A CAR DETAILED

Soft Touch Hand Auto Wash

4917 North 40th Street

468-0615

Soft Touch Hand Auto Wash is the Elizabeth Arden of car pampering. And believe us, our car needs to be pampered.

Like most Phoenicians, we practically live in the car, perfecting the art of blending left-brain/right-brain functions--applying mascara while maneuvering stop-and-go traffic; scarfing a Dairy Queen Blizzard on the Squaw Peak Parkway. And we haul everything from portulaca to Rosy, our loyal spaniel, whose irrational attraction to water puts a special hurt on our chariot.

After a year of such abuse, our car needed more than just a bath. It needed a day at the spa. So we dropped it off at Soft Touch for a few hours.

Upon our return, the exterior gleamed with its newly waxed sheen and jewelrylike sparkle of our hubcaps, but the greater accomplishment lay inside. We were positively delighted by the white-glove spotless--shampooed, polished, Armor-Alled--interior. No more coffee splatters on the rearview mirror. No more puppy-nose marks on the windows. No more gunk in the cup holders.

It was almost like having a new car. We've even managed to keep from spilling anything since--Rosy's accidents aside.

Readers' Choice for Car Wash: Danny's Family Car Wash

BEST FRAME SHOP

The Mat Corner

1020 South Mill, Tempe

966-2055

Everything we know about homemaking, we learned from Mom: Always paint a room lighter than you think it will turn out. If your house plants die, don't worry; just go buy more. Don't try to fix broken appliances yourself. And don't scrimp on framing.

Mom's right. A good custom frame will turn that $20 poster into a masterpiece. We trust such tasks to the folks at The Mat Corner, a frame shop tucked into the corner of an art gallery just west of Arizona State University. The employees are helpful but not pushy, and on a recent visit, we found ourselves talked into the cheaper of two framing options.

Our frames were ready when promised, and the work was of high quality. We made sure to tell Mom, who had one more piece of advice: "Don't hang those pictures too high, sweetie. That always drives me nuts."

Readers' Choice: Michaels and Old America Store Framing (tie)

BEST SWAP MEET

Park 'n' Swap

3801 East Washington

273-1258

Get one thing straight: Park 'n' Swap has everything--discount vises and drills, personalized pet tags, games for your '80s-era Intellivision, cowboy boots--all sprawled over the Phoenix Greyhound Park lot. Painstaking diligence is the secret to finding what you want. We wouldn't dream of trying to do Park 'n' Swap in one day--the successful shopper has a plan and attacks over a full weekend. To be safe, hell, go every weekend.

Pay attention to the barker so you don't miss any bargains. Until you've heard her call, "Scrunchies, scrunchies, scrunchies!" or "Kachinas, kachinas and more kachinas!" you haven't really shopped.

Budget tip: Park 'n' Swap is close to the airport, and a quick stop for those obligatory Arizona tee shirts and hats for the relatives you're visiting in the Midwest. Why pay top dollar at Sky Harbor for a "But it's a dry heat" tee shirt with a skeleton collapsed under a cactus?

Open Wednesday 4 to 10 p.m.; Friday 6 a.m. to 2 p.m.; and Saturday and Sunday 6 a.m. to 4 p.m. Get there early for the best stuff.

LOAD-DATE: October 22, 1996

Evidentiary Exhibit Number 165

Portland Press Herald (Maine)

September 13, 1996, Friday, CITY EDITION

SECTION: REAL ESTATE, Pg. 2F

LENGTH: 1123 words

HEADLINE: FOR MANY PEOPLE, RENTING HOME IS WISEST;
MONTHLY PAYMENTS ARE LIKELY TO BE LOWER AND YOU DON'T HAVE THE RISKS THAT GO;
WITH OWNING PROPERTY.

BODY:

When Sue and Fred Rowe left their native city of Richmond, Va., and moved to Maine after vacationing here for eight years, they knew they wanted to buy a home.

But because they didn't want to make any impulsive decisions that they might later regret, they opted to rent a small house in Cape Elizabeth. It turned out to be a smart move.

"I'm glad we didn't move up here and buy right away," says Sue. "If you buy too fast, you worry that you have made a mistake."

For those who want the privacy and space of living in a house without the hassles of maintenance and the huge financial commitment of down payments and mortgages, renting a house may be the best option.

One obstacle renters sidestep is the often huge down payment involved in purchasing a home.

According to Ralph Lamb, president of Apartment Rental Specialists, a rental agency in Portland, most down payments are in the 10 percent range, making the down payment on a $ 150,000 house $ 15,000. The Federal Housing Authority does have programs that allow low income families to make a down payment on a house for as little as 3 percent.

"A lot of people don't have that kind of money," says Marc Fishman, a broker at the Fishman Realty Group in Portland. "Or if they do, they would rather pay more in rent and let their money work for them in other areas like the stock market and mutual funds, rather than tie up the equity in their house."

Lower monthly costs

Renting a house can also significantly reduce your monthly payments.

"You can go out and rent a four bedroom, two-and-a-half bath house with a two car garage in a nice neighborhood for somewhere between $ 1,000 and $ 1,500 a month," says Fishman. "If you were to buy the same house, it might sell in the area of $ 200,000 to $ 250,000. With 10 percent down at 8.5 percent interest over 30 years, the monthly payments would be around $ 2,000, including principle, interest, tax and insurance. We rent out a multi-million dollar home and to own this house you would have to be a millionaire. The taxes alone would be over $ 10,000 a year. But to rent it, it's under $ 3,000 a month."

Fishman says that many of the people who rent houses do so for job-related reasons. Local corporations such as Unum and National Semiconductor bring in employees from outside of Maine who stay anywhere from one to three years.

According to Fishman, corporate transfers usually don't buy "because if they bought now and then got relocated in a few years and had to sell when the housing market was down, they would lose a lot of money."

Maintenance-free living

Many renters also enjoy maintenance-free living. Although tenants are usually allocated some responsibility for the maintenance of the home, major repairs such as interior and exterior painting, plumbing and electrical problems are typically the responsibility of the landlord.

Maintenance expenses are often not accounted for when prospective homeowners consider their budgets.

"You're not only paying your mortgage, you're also paying taxes, mortgage-related fees and utilities," says Fishman. "You have to buy a lawn mower, you have to deal with snow removal, you have to paint every couple of years. It's expensive."

There's also less risk in renting. Many homeowners and real-estate agents remember the real estate crash of the late 1980s, when buyers paid highly inflated prices for their properties. When the market crashed, so did the value of their homes.

"What if you buy a house and the real estate market crashes like it did in the '80s - and then you lose your job and you have to sell that home at a huge loss? That's a genuine risk in today's economy," warns Fishman.

In fact, many homeowners who decide to rent out their homes do so only because they are unable to sell them without suffering a loss.

Whether you're renting for life or renting temporarily for business reasons or until you find a suitable home to buy, here are a few tips to securing yourself a rental property.

Space comes first

"If you find a place that has enough room for your family or for your situation, my advice is get it," says Fishman. "If you wait a few days to think about it, in this tight rental market, chances are it's going to be gone."

Try to be open-minded about different communities. Fishman says that a lot of people are insistent about being in a certain area.

"The ones who must be in a certain area are the ones who end up paying the most. Try not to have your sights set on a particular style or neighborhood." After all, your commitment is for only the length of your lease.

Seasonal rentals can be great bargains for someone who wants to move to Maine and buy a home but who doesn't want to make any hasty decisions. Beachfront houses in areas such as Old Orchard and Higgins Beach are offered for shorter terms (usually six to nine months during fall, winter and spring) with monthly rents averaging between $ 800 to $ 1,000. A seasonal rental in a new community gives you the opportunity to get settled, get your kids to school and yourself to work. Meanwhile you'll become more familiar with the area and the buying market.

Word of mouth

Fishman says that many rental properties never make it to the classifieds. Tell everyone you know - friends, co-workers, your softball team - that you are looking for a place. Chances are, someone will know someone who wants to rent.

If you are a homeowner who can't sell your home because to do so would mean a loss, you may want to consider renting it to buffer some of that loss, although there are potential downfalls.

Careless or abusive tenants can decrease the value of your home.

Chris Christensen, vice president of marketing for the American Homeowners Foundation in Arlington, Va., has had negative experiences in renting out one of his homes.

"There's no question, if you own a home, you maintain it. If you rent it, you don't says Christensen. "That can mean a significant depreciation in the value of the house."

A tip for those who want or need to rent out their own home - go through a rental agency. For a fee (usually an amount equal to the first month's rent on the property), such an agency can screen potential tenants extensively, maximize your rental income and maintain objectivity when it comes to making a decision about who will be in your home.

And remember, not all renters are slobs.

"Everywhere we've rented, when we left, the value of the home had appreciated," says Fred Rowe. "We keep the grass cut, and the gutters clean; we do most everything except the major stuff. We do everything a homeowner would do."

Meghan Herguth is a freelance writer who lives in Kennebunkport.

LOAD-DATE: September 14, 1996

Evidentiary Exhibit Number 166

ASAP

Boating Industry

September, 1996

SECTION: Vol. 59 ; No. 9 ; Pg. 105; ISSN: 0006-5404

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HEADLINE: Nine dealer profiles; boat dealers

BYLINE: Brown, David ; DeFranco, Liz ; Healy, Justin ; Schroeder, Peter ; Seideman, Tony ; Thompson, Tom

BODY:

Boat retailers reveal tactics that have worked in the very competitive mid-'90s market.

This year's nine dealer profiles represent a varied group. Geographically, they range from Seattle in the Northwest, with its very special brand of boating, to warm, sun-drenched Puerto Rico. In our selection process, at least two sources had to recommend each dealer for profiling. Those sources were a mixture of boatbuilders, national and local marine trade associations, other dealers and the observations of our editorial staff.

When seeking recommendations, we were quick to specify the criteria that are important to us. We do not necessarily want to find the largest dealers in a market. What we do want are those dealers who are excelling at one or more areas of dealership management - and are willing to talk about it. In other words, who is making the best of the tools available to them? All our editors work from the same interview sheet, which lists more than three dozen questions. We do get turndowns occasionally - some dealers do not want to reveal their "tricks of the trade" and others just don't want the publicity.

Boating industry would like to express its thanks to those dealers who did consent to be interviewed for this year's profiles. We hope that what is revealed will act as a catalyst for other dealers to improve their operations. We certainly welcome all comments readers have regarding this year's selection, particularly reactions to the management ideas presented.

Among the nine dealers selected were several who have been in the business relatively short times. Most notable is Morgan Rapp, a Correct Craft dealer in Aurora, Colo., who is now in only his 15th month of business under his Preferred Boats & Sports Center banner. He has hit the ground running, already gaining tons of customer loyalty.

As you read the profiles, analyze why dealers have pursued the particular course they have with various management and promotional solutions. One thread that was fairly common among those interviewed this year was the effectiveness of direct mail programs in reaching prospects. Look for a feature story on cost-effective direct mail in the October issue of BOATING INDUSTRY.

Boats Inc. NIANTIC, CONNECTICUT

Vital Statistics

FACILITIES: Full-service boat dealership and marina on 2.5-acre site with 186 slips and 16,000-square-foot building that includes showroom, ship's store, and repair and custom rigging facilities.

EMPLOYEES: 24 full-time and four seasonal, including partners Brian Olson, president and general manager, Don Mackenzie, vp/sales manager; Peter Rothman, vp/service manager, and Gary Mallows, vp.

PRODUCT LINES: Albemarle, Boston Whaler, Grady-White, Parker; Evinrude and Yamaha outboards.

YEARS IN BUSINESS: 38 (10 under Olson)

SALES BREAKDOWN:

New boat & motor sales 66%

Service 12%

Parts & accessories 8%

Used boat sales 8%

Slip mooring and rentals 6%

Brian Olson loves boats, fishing and the water. Like most boat dealers, he understands that romance is one of the driving forces behind his business; the sharp, tangy smell of salt and the sea, graceful white hulls slashing through and over the water; victorious fishermen bringing in a day's catch.

Unlike all too many dealers, however, Olson understands that it's hard to build a true foundation for success upon warm, fuzzy feelings. A decades-long veteran of the consumer products industry, Olson spent years selling soda and beer in some of the world's most competitive markets for Philip Morris, a company renowned for its advertising and promotional savvy.

"Their marketing influence in terms of my experience was significant," 47-year-old Olson says of Philip Morris, Ford Motor Co. and Brunswick Co., the other corporations he worked with before purchasing Boats Inc. a decade ago. And he feels the lessons he learned have played a primary role in making Boats Inc. one of New England's most important dealers, with revenues "in excess of $ 5 million" a year and 25 employees.

Olson got into the boating business almost by accident. Philip Morris was spinning off 7-Up, his current brand, and he felt the time had come for a change. He saw Boats Inc. for sale in the business opportunities section of the Hartford Courant newspaper.

Before he purchased Boats Inc., the only experience Olson had of the boating business was as someone who'd been an active boater for most his life. Luckily, the business he purchased was a strong one, and the boating business had three good years - '87, '88 and '89 - before the market collapsed. An excellent locale added to the company's strength and stability. Perched on the shores of Connecticut's Niantic River, Boats Inc. has easy access to Long Island Sound and is little more than an hour from Hartford, Conn., the effective capital of the nation's insurance industry.

An affluent customer base has translated into strong profit margins. Boats Inc. carries four lines of boats - Albemarle, Boston Whaler, Grady-White and Parker - and two of outboard motors - Evinrude and Yamaha. "What we sell is typically in the higher end of the scale," Olson says. Three of the four lines Boats Inc. carries are North Carolina boats for a number of reasons. "Some of the best boats made for bluewater use are built in that region," Olson says, "and the furniture-making capital of this country is also in North Carolina." Because of that, "the finish work we feel is superior to that in any other region for the style of boats we sell," he says. "They have a heritage of making quality boats."

While tradition may shape the vessels Boats Inc. sells, many aspects of the company are decidedly untraditional. In an industry that is sometimes still phobic about any technology that doesn't go in a deckhouse, there's a computer on almost every desk at Boats Inc: "All our key managers are on a PC-based Windows system, and we have a Unix system for our multi-user ship's store parts system," Olson says. Unix is a

sophisticated computer language designed to make it easy for many different machines to work together. Boats Inc.'s information infrastructure plays a key role in the company's continuing success, he says.

Unsurprisingly, the company's parts department is fully computerized. But Boats' digital background also reaches into the company's marketing department. "We have been highly automated for some time, including a database system for lead management," Olson says. Intensive use of computers enables the company to quickly and efficiently respond to potential sales opportunities. Boat shows are the most important element in the dealership's marketing mix. Cheap and effective PC power allows the company to fine-tune this sometimes awkward sales instrument.

"In terms of efficiency and speed during a boat show, we'll routinely get out mailings while a show is still in progress," Olson says. "Our database is interactive with our word processing," which makes things move all the faster, he says. But perhaps the most important impact of computers has been on the company's management strategies. "A lot of the management is done with the aid of the computer," he says.

Boats Inc. closely watches inventory turnover by brand. "We watch the contract cycle," Olson says. "As we take the contracts, we can compare them with prior years. We do sales forecasting; we compare our actual sales to our forecasts and to our prior year's sales history."

The key is to do what his business needs, not what suppliers want. "We try to drive our inventory based on consumer demand rather than manufacturer's programs, and that helps keep our turnover rates higher," Olson says. The result is in the numbers: while most dealers see their inventory turn an average of 2.5 times a year, "We're getting better than three," he says.

Going against convention seems a standard practice at Boats Inc. Where many dealers hold on tightly to every possible fragment of control of their companies, Olson has two junior partners. Both of them have degrees, but neither of them is doing what would be expected given their educations. Sales manager Don Mackenzie has a degree in engineering; service manager Peter Rothman in accounting. "They're both equity partners in the business: one runs the front end and the other runs the back end of the business," Olson says. "Peter's a better mechanic than an accountant," he says.

Creative use of staffers runs all the way through Boats Inc. The company gives everyone who purchases a boat a free three-hour introductory course. One of the best teacher-salesmen is Joe Sobolewski, a retired Kentucky school teacher who has set national and international boating records. "He brings a very strong knowledge of boating because of his own personal experience," Olson says. Combine that with years of teaching skills and Sobolewski's experience on his own 42-foot Grand Banks, and the company has an almost perfect salesman.

One high-tech area Olson eschews is the Internet. He feels the globe-spanning computer network is simply too diffuse to meet his needs. Instead, he concentrates on advertising in regional publications such as Offshore magazine. He also spends regularly and relatively abundantly. "We have a substantial frequency in this and other publications," he says of Boats Inc.'s marketing expenditures. The company invests more, not less money on marketing during weak economic times, he says. "During the downturn, we spent more money on advertising on a percentage basis, and that helped us remain visible during the better times," he says.

Wherever Boats Inc. spends its marketing money, Olson believes in using a rifle rather than a shotgun. "I guess if there was anything I learned at Philip Morris it was focusing on niche marketing," he says. Boats Inc.'s target audience is affluent fishermen, and keeping that focus is serving the company quite well, he says.

While the present is more than comfortable, Olson is less than sanguine about the future. "We're going to be dealing with a shrinking market for the type of goods we sell, particularly as the baby boomers mature," he says. "I hope they don't get out of their boat shoes and jump into golf shoes," he says. "What we sell, nobody needs. It's only a want." That means only the best will survive. Boats Inc. feels it's in that category. And the company intends to stay there.

- Tony Seideman

Compass Point Yachts SEATTLE, WASHINGTON

Vital Statistics

FACILITIES: A 2,300-square-foot waterfront sales, service, charter and maintenance facility with docking slips for 28 yachts; in Portland a waterfront 1,100-square-foot facility with 15 docking slips.

EMPLOYEES: 18 total including owner and sales manager Bill King; Portland manager Mark Lee; charter manager John Howe; service and yacht care, Larry Clarke; accounting, Christine Newcomb; financing and insurance, Meagan Randall.

PRODUCT LINES: Ocean Alexander, Silverton.

YEARS IN BUSINESS: 3+

SALES BREAKDOWN:

New yachts 45%

Brokerage 45%

Charters 5%

Service & yacht care 5%

To hear Bill King talk about his marine dealership, Compass Point Yachts, you'd think he had grabbed a rocket ship just as it was taking off. Starting from scratch in a small office in Seattle in December 1992, he built a company that has outgrown its premises four times, expanded with a second office in Portland, Ore., increased sixfold its original staff of three, and is on track this year to exceed $ 20 million in sales. Representing Silverton and Ocean Alexander Yachts as well as offering brokerage services, Compass Point Yachts is today one of the most respected marine dealerships in the Pacific Northwest.

King entered the boating business in January 1987, after the financial insolvency of his previous employer, a wood stove manufacturer, cost him his job as marketing manager. Although he had been a boater for only two years, he decided to change industries and was hired as a broker for Vantare Yachts in Seattle a few days before the Seattle International Boat Show.

"At the boat show I spent 10 days on a motoryacht, got several leads, and followed up with a few sales," says King, recalling the first days in his new work. "The important thing is that I learned I liked the people in the industry and decided to stay in it."

A year later King left Vantare to join Seattle-based Western Yacht Sales where he worked five years, eventually moving up to sales manager. After leaving Western Yachts, King sold brokerage boats for Dave Maples Yacht Sales, one of the most well-known brokerages on the West Coast.

After a year with Maples, King felt he understood the industry and the Northwest regional boating market well enough to set up his own business. In partnership with Terry Cooke, president of Compass Point Yachts

Ltd. in Vancouver, B.C., King founded his Seattle company of the same name in December 1992. In August 1993, King extended operations to Oregon by establishing an office in Portland. The concept was to share the vast market of Western Canada, previously developed by Compass Yachts Ltd., and the U.S. market in Oregon, Washington and Alaska. The company focused on brokerage yachts and represented the Millville, N.J.-based Silverton yacht line with models ranging from 27 to 46 feet.

Recognizing that the Silverton design layout was not suited to Northwest cruising conditions, King convinced their designers to modify one of their models with an inside lower helm station in addition to the usual flybridge controls. Silverton found this change was needed for their markets in Europe and South America as well as for the Great Lakes region and was willing to comply. Now, according to King, the boatbuilder is working this modification into all its models.

King had been impressed with the Taiwan-built Ocean Alexander motoryachts that he had represented while working at Western Yacht Sales. When the opportunity arose in early 1994 to take on representation of these luxury yachts - which include 32 models ranging from 39 to 76 feet - at his Portland base, he jumped at the chance. Six months later he expanded his Ocean Alexander Yacht representation to his Seattle location as well.

"I had previously met Alexander Cheuh, owner of Ocean Alexander, and learned that with the Chinese, lots of things are based on trust," King says. "We had earlier developed a trust with each other, so we were in a good position to get together in business. Furthermore, unlike some Silverton models, which aren't suited for the conditions in our market, Ocean Alexanders have been designed by Ed Monk Jr. a noted Northwest naval architect , and he knows what Northwesters need for cruising comfort."

Historically, Washington was the best market worldwide for Ocean Alexander, thanks to the efforts of the late Jerry Schei and his company, Western Yacht Sales. Picking up on this momentum, Compass Point staff produced record West Coast sales in its first year for Silverton and Ocean Alexander. The highlight came last year when Compass Point was awarded the Ocean Alexander top sales award worldwide.

In January 1994, the need for more office and moorage space prompted King to move to larger facilities with more dock space on Seattle's Lake Union. As a new-boat dealer, he felt it was essential to have adequate nearby moorage to properly display models of the lines he represented. King relocated and subsequently expanded his offices three more times in the same building, which coincidentally is owned by Ocean Alexander's Cheuh of Kaohsiung, Taiwan.

King admits that he was quite lucky with his timing. "When I started my business the luxury tax had just been repealed and the shock of its impact had tapered off and was going away," he says. "The economy had picked up and people were beginning to buy boats again."

Last January, King extended his business into a new nautical adventure, Compass Point Yacht Charters. This gave options for cost savings and tax benefits to his Ocean Alexander clients to put their boats into charter operation at locations in Seattle or the San Juan Islands. The business became an instant success with bookings quickly filling for the summer months and most of September. King admits chartering is not a big moneymaker for Compass Point, but it offsets some costs and gives potential buyers an opportunity to check out a yacht before stepping up to purchase.

Chartering lends itself to many creative marketing strategies that King has been quick to seize upon. Particularly popular on home college football weekends is the option to charter yachts equipped with mooring permits to dock at the waterfront end of the University of Washington's Husky football stadium, allowing on-water tailgate partying. During slack periods when the boats aren't being used for charter, King makes them

available to a waterfront bed-and-breakfast operator who books overnight guests. One additional advantage is that having a charter operation nearby gives his salespeople alternative models to show.

Also new this year is a Yacht Care and Service Department which brings in-house much of the work that was previously subcontracted out. This department handles commissioning and minor alterations such as adding electronics, dinghy davits, etc.

A new business direction that King now intends to pursue is yacht financing. "Yacht financing methods in our area are changing drastically," King says. "Local banks have always known that boat loans are good loans and make money. But many of our banks have been bought up by out-of-state banks that are closing these departments. Wells Fargo Bank doesn't have a yacht division, and Seafirst has backed away. First Interstate is much less aggressive and has shut down its yacht financing department. Credit companies seem to have lots of money available for boat loans, so we'll be working with them to get the financing that our customers need."

King also works with local private investors not only for his customer's benefit but for his own as well. As a result, last December he bought out his Canadian partner's share and now is fully independent.

Although King has a Web site on the Internet and advertises regularly in regional boating publications, he finds direct mail most effective. Working from a database of 8,000 names, he feels, is the best way to reach his key market. Although he does not yet advertise on radio or television, he hopes to use these media as soon as he has a larger presence in the market.

King is a regular participant in the Northwest Yacht Brokers Association annual January, May, and - new this year - September on-the-water boat shows. He participates in three Portland boat exhibitions. The primary boat show for Compass Point Yachts, as well as for all Puget Sound marine dealers, is the January Seattle International Boat Show put on by the Northwest Marine Trade Association.

King has been active in the two major boating associations in the Pacific Northwest. He is past president of the Northwest Yacht Brokers Association, a position now held by Wayne Smith, one of Compass Point's brokers. Last year, King was elected to the Board of Trustees of the Northwest Marine Trade Association. However, due to policy disagreements with other board members, King and three other directors resigned from the board last spring.

King attributes most of his company's success to his people. "The hardest work I have done is to bring in good people who are all boat owners themselves or boat users who really understand what the buying public is going through when it comes to purchasing a boat," says King. "We really try to service our customers both before and after the sale. We help a new owner learn to drive, maintain, and dock his boat. We are always completely on the up-and-up with clients and vendors, and we have built a fairly decent reputation in a short time."

King is proud of the high quality of his staff. All his brokers are required to become members of the Northwest Yacht Brokers Association, an organization committed to fostering ethical standards in the industry. Members of the staff regularly volunteer their time at the Brokers Association and the Northwest Marine Trade Association.

"In life, I believe one should either step up or shut up," says King. "At the Northwest Yacht Brokers Association and Northwest Marine Trade Association I tried to give as much assistance as possible because I believe in these types of associations. They should create a level playing field to help people and the industry overall in reaching those who don't yet know the beauty of boating in this part of the world."

- Peter S. Schroeder

Preferred Boats & Sports Center, Inc. AURORA, COLORADO

Vital Statistics

FACILITIES: Dry, single-location new and used boat dealership; repairs, parts and accessory sales; off-season storage; PWC & snowmobile rentals; full line of water skis, ski clothing and accessories.

EMPLOYEES: Three full-time, one part-time.

PRODUCT LINES: Correct Craft

YEARS IN BUSINESS: 1-1/4

SALES BREAKDOWN:

New & used boat sales 30%

PWC & snowmobile rentals 25%

Labor 25%

Boat and ski accessories 15%

Storage 5%

Success is attitude. That's the way Morgan Rapp sees it. Rapp, an enthusiastic 30-year-old Coloradan, is president of Preferred Boats & Sports Center, a remarkable success story in its short history. Rapp's attitude, rooted in his strong Christian beliefs, has built the firm's reputation, largely by word of mouth, and established it as a successful ski boat dealership and accessory center in less than two years.

"I'm very open and up-front with people," Rapp explains. "I tell them that we want to be able to do something that's going to work for everyone." He isn't pushy, he says. He doesn't try to close the deal today. "I tell a customer if it was meant for you to own a Correct Craft, you will. I've carried on the way I like to be treated in my way of doing business with other people."

The proof is in the numbers. In the year after opening its doors in June 1995, Preferred Boats & Sports Center - with a goal of selling 12 boats based on the old Correct Craft dealer in Colorado having sold 11 boats in its best year - delivered 36 Ski Nautiques. That was a notable achievement, considering the fact that Rapp's company started from scratch at an entirely new location. What's more, the Ski Nautique name was fighting against a well-established Mastercraft presence in the market.

Morgan Rapp's attitude is contagious. Although there are only four employees at his company, he says Preferred has a large, strong sales force in his satisfied customers. "Everyone we've sold a boat to sells boats for us," he says. "I think it all goes back to the fact that we are very blessed with the relationship with all of our customers. I strive to build it and make it very evident that's the way we do business. That, in all honesty, I think is our biggest success story. Customers even call us during boat show season to volunteer for setup and teardown chores, as well as for booth duty offering testimonials on our service and the quality of the Correct Craft product."

Rapp's entry into the boating industry happened in a roundabout way. He operated an automotive detailing business and took on the previous Correct Craft dealer as a client. Rapp was bitten by the boating bug when the owner offered him a position as manager of the dealership plus the personal use of a demo boat. The dealership was for sale at the time, and Rapp considered buying it, but was convinced otherwise by his father.

"I'm a strong believer in the fact that things happen for a reason and they are meant to be," Rapp says. Ron Goodrich, Correct Craft's regional sales manager, took note of Rapp's enthusiasm and energy. The company offered him the opportunity to take on the line himself while Rapp was attending a dealer meeting in Orlando.

Because he needed financial backing, Rapp turned to his father, a real estate and land developer. "My dad said he thought I had lost my mind," Rapp laughs. He ultimately managed a convincing argument, and the deal went ahead. Rapp sold his first Ski Nautique at a boat show, before the store actually opened, and things took off from there.

Preferred Boats & Sports Center is located in the main business district of Aurora. The property is just over 1 acre. The building has a 2,500-square-foot retail and boat display area, two offices and 1,400 square feet of shop space. The nearest water is some 10 miles away at a state park, where demos are done. It doesn't seem to be a drawback to business, Rapp says. "Colorado is a very outdoors activity state. We've got everything to offer here except ocean."

Rapp feels an inventory of 10 to 20 boats, both new and used, is an adequate number for his market. Stock is completely floorplanned, mostly with Greentree Financial Services, although about 10 percent of his credit line is through Aurora National Bank.

In addition to boat sales, Preferred carries a selected line of skis, wakeboards, clothing and accessories. "We are staying small with limited quantifies," Rapp points out. "I'm not worried about being the big glorified number one of the world. I just want to be very product-knowledgeable and very customer-service oriented." Rapp offers all new-boat buyers a 15 percent discount on any ski accessories they purchase, as he puts it, "for the lifetime of our relationship." Preferred also rents personal watercraft during the summer and snowmobiles in winter.

As for promotion, so far the only advertising Rapp has done is in the yellow pages. He attended five boat shows in the past year. "This fall, we are doing an on-water demonstration with our '97 product, and we have a couple of pro skiers coming to town so we can do some training sessions," Rapp says. He also believes in community involvement, and has signed on as lead sponsor of the Aurora Police Department's First Annual D.A.R.E. Softball Tournament. Plans are to display six boats on a city park pond adjacent to the ball field.

Because growth is coming so rapidly, there's hardly time to focus on areas for improvement, Rapp says, but he does have plans for the future. He's hoping to expand staff to take some of the load off his shoulders. He recently hired a general manager, Shelley Buttshaw, and with it got the support of her whole family. Rapp's wife, Michelle, helps out part-time, and his mother is the company accountant. Rapp credits his entire family's support, especially that of his grandmother, for the success he has enjoyed. Rapp lost manager Cara Randolf to Arizona State University, but is looking forward to her return during boat show season, summers, and eventually full-time duties again after graduation.

"I will still be 100 percent involved in every one of our boat deals," Rapp emphasizes. "And I always will, because of my pride and attitude with Correct Craft. I don't want to relinquish that to anyone."

Rapp has a seven-year plan in which he would like to open two more satellite stores.

With the refreshing attitude that abounds at Preferred Boats & Sports Center, long-term success is bound to come naturally. "That's what we're striving for," Rapp says enthusiastically. "Lo and behold, the good Lord willing, it's all coming together. Our dealership is just running great. We're obviously turning heads."

The motto of Rapp's dealership was a favorite saying of his paternal grandfather, William T. Rapp: "Don't expect anything less than the best from our family to yours."

- Tom Thompson

HMY Yacht Sales DANIA & PALM BEACH GARDENS, FLORIDA

Vital Statistics

FACILITIES: Two-location dealership and used boat brokerage specializing in craft over 30 feet in length. Outfitting and maintenance services provided. Major service is subcontracted to nearby facilities. No accessories sales or boat storage.

EMPLOYEES: 26, including principals Steve Moynihan and Willis "Doc" Austin.

PRODUCT LINES: Viking Yachts, Viking Sport Cruisers, Cabo, Post.

YEARS IN BUSINESS: 17

SALES BREAKDOWN:

New boat sales 50%

Brokerage sales 50%

HMY Yacht Sales is a hands-on company. That's because its principals, Steve Moynihan and Doc Austin, are the kind of people who are deeply involved in their business. They come to the office every day. They can pull current inventory out of their heads. They each know the status of every deal in-house.

"We both have the same thought processes," Austin explains. "We've been doing it for a long time. What's made us successful is being able to anticipate each other's thinking."

Austin and Moynihan have been equal partners in HMY since 1983. Moynihan began the company in 1979 with two others, hence the name, but they were subsequently bought out as Austin arrived. The firm was originally a brokerage, based in Fort Lauderdale Fla.. HMY took on its first new boat line, Post, in 1983. Viking Yachts made them a dealer in 1993, and Cabo, in 1994. Last year they signed as one of the newly formed Viking Sport Cruiser line's first outlets.

Technically speaking, there are two companies that are HMY. The brokerage side of the business is HMY Yacht Sales Inc. with Moynihan as president and Austin as vice president. The roles reverse at HMY New Yacht Sales Inc. The Dania office is at Harbour Towne Marina, a large full-service facility near Fort Lauderdale. Seventeen people work there. In Palm Beach Gardens, HMY has a spot in similar surroundings at Soverel Harbour Marina. It was opened in 1994 and now employs nine.

Because of their locations, neither HMY office directly provides more than outfitting and basic maintenance. All repairs and other work are subcontracted among the array of vendors available at both Harbour Towne and Soverel. Another advantage of the siting is the ability to provide an extensive showroom. "We can have 50 boats in the water at Harbour Towne and 25 at Soverel during the peak season right at our front door," Moynihan says.

Typical inventory levels fluctuate between $ 5 million and $ 15 million, according to Moynihan. About half are new boats, which he considers a good mix. "We sell over a million dollars a week," he says.

To promote the business, Moynihan and Austin spend about $ 500,000 annually promoting HMY. Some 60 percent goes to a media schedule in national and regional boating magazines, along with newspaper advertising primarily in South Florida. Another 20 percent goes toward publishing HMY's own full-color magazine called

Setting Course. With a circulation of 12,000, it is distributed to Viking, Post and Cabo owners, along with other dealers, brokers, marinas, lending institutions and various marine-related businesses.

"We were looking for something that was a follow-up to the sale," Moynihan says. "A lot of the magazine is dedicated to people who have just purchased a boat." Photos of customers fishing, cruising and enjoying their boats abound.

The remaining 20 percent of the promotional budget goes toward boat show participation in Miami, Fort Lauderdale and Palm Beach. HMY also exhibits with Viking at the Norwalk International and Annapolis shows as well. That came about as a natural course of events, because HMY is Viking Yacht's largest dealer.

Moynihan is modest about the distinction, achieved in the short course of three years: "It had nothing to do with us. The market was coming back. The luxury tax was rescinded. We are in the best boat market in the world, we think. That combination plus having a superior product has just brought a lot of people into the market." HMY was also named the number one Post dealer last year, and ranks near the top in Cabo sales.

Although HMY doesn't specialize in any particular type of yacht sales per se, most of its business has been in larger sportfishermen, cruising convertibles and motoryachts. "We are in every market, but that's where we've had the most success," Moynihan says. "I think most brokerages don't have the desire or the facilities to take trades, but we are a trade-in broker. If a customer wants to buy a boat, and there's a trade in the middle of the deal, we'll take it."

Moynihan also feels the multiple locations set HMY apart from competitors, along with his and Austin's level of participation in the day-to-day operating of the company: "I think that the customers are very well aware of the fact that we are here, on deck, and so very involved in the business of marketing and selling boats. I still go to the factory and make deliveries myself."

"It's a desire, a motivation," Austin adds. "We both desire to be in this business and be at it every day."

That sense of commitment extends down through the ranks. Longevity is an important factor. The Dania office manager has been with the HMY since day one. Several sales people have more than 10 years tenure. All employees are required to take manufacturer training, including office support staff. "When a customer walks in and has to wait, the secretary can speak intelligently about her last visit to the factory and what she saw," Moynihan says.

"Our people are our best asset," Moynihan says. "We try every day to make sure that each of our people is in tune with the customer, and that the customer is king."

Moynihan and Austin both see growth in the future for the marine industry and their business. "Customers are demanding more quality so they can enjoy more of their leisure time," Moynihan says. "We have what it takes to make that leisure time better."

"We're looking to the future and to expansion," Austin says. "We're both committed to this industry and have been for a long time. It's our sole livelihood. We just want to get better."

- Tom Thompson

Sea Ray of Charleston CHARLESTON, SOUTH CAROLINA

Vital Statistics

FACILITIES: One-store dealership with showroom, accessory shop and service facilities located on 2.5 acres.

EMPLOYEES: 13, including Rick Hall, president; 3 salespeople: John Douglas, sales manager, Bill Hart, Hellen Krull; service manager Stan Kasynia; 3 certified technicians, Jamie Parks, Dale Lackey, Joe Markey; parts manager Joyce Ivie; bookkeeper Dot Maxwell; receptionist Betsy Frick; and two yard workers, Mark Loftin, Terry Glascock.

PRODUCT LINES: Sea Ray

YEARS IN BUSINESS: 9

SALES BREAKDOWN:

New boats, motors & trailers 85%

Used boats 4%

Parts 4%

Service 4%

Sea Ray of Charleston is not easy to find. To get there, you turn down an unmarked street opposite a correctional facility, pass a bail-bond company, a lawyer's office and finally dead-end into the back of Sea Ray of Charleston's (SRC) facility.

It seems an unlikely place for a successful, high-end boat dealer - until you see the front. SRC's 2-1/2 acres of land face Highway 526, one of the busiest thoroughfares in Charleston. Every day, more than 50,000 vehicles pass the Sea Ray of Charleston sign.

The choice of this location has been a significant element in SRC's success, according to Rick Hall, president and manager. He started SRC after four years working as a regional manager for Kansas City, Mo.-based Covert Marine, a now-defunct distributor of marine accessories. As a child and teenager, Hall spent his time working at his father's 185-slip marina and dealership in Lake Wylie, S.C. Rod Hall, Rick's father, had called him in 1986 and asked if he would help him pick up a 44 feet Sea Ray. While making the delivery, the elder Hall told Rick that Sea Ray wanted to set up a location in Charleston.

"Pop convinced me to come on in and make this thing happen," Hall says. "He offered me a set amount of money," says Hall. "Then he told me to go find a piece of land and do it."

The younger Hall did it. SRC, in concert with three other dealerships owned by the family, is one of the largest Sea Ray dealers in the world.

Hall laid out SRC's showroom with one purpose in mind: selling boats. Adapting layouts used by other successful dealers, he set it up with just one entrance for customers. That entrance is watched over by Betsy Frick, the receptionist. "I designed the showroom so we would have control of traffic," says Hall. "With only one way in, customers wind up being seen and waited on promptly," he adds. Once in the immaculate display area, customers can have no doubt that they are in a Sea Ray dealership. The floor is jam-packed with Sea Rays. Posters on the wall proclaim the virtues of Sea Ray boats, and awards the boats have won. One poster, right at the entrance, starts prospective buyers off on the right foot. It lists 10 reasons to buy a Sea Ray. There is no identity problem here.

According to Rick Hall, a strong and clear identity is one of the reasons for SRC's success. "When a customer comes into our store, they know that we carry Sea Rays and only Sea Rays," says Hall. "It's right there in our name." Customers come to Rick's shop because they want to look at Sea Rays, period.

"We have not tried to be all things to all people," Hall says. "We've focused on selling one good product and on doing that well." Hall adds that he thinks dealers with too many boat lines wind up unable to do justice to any one of them.

Conservative financial planning and a broad base of support have enabled SRC to weather downturns in the industry. The family has boating-related businesses that draw on a variety of income streams. There is the marina and dealership at Lake Wylie, a dealership on Lake Norman just north of Charlotte, N.C., managed by Rod Meyers, and a fourth location in Columbia, S.C.

When the need arises, each of these facilities is able to bolster the finances of the other. Because it is company policy to avoid over-leveraging debt, this has almost never been necessary. The Halls financed just 60 percent of SRC through a local bank. The rest of the money came from revenues generated at the family's Lake Wylie and Lake Norman locations.

"We make a point of planning our financing based upon weathering down-turns in the market," Hall says. Even with that kind of support and financing, the last recession changed the way SRC works. To make up for the shortfall in sales and income, Hall cut costs by laying off two employees. Since then, the company has increased its sales without increasing its work force. The net result has been better profitability.

Repeat business is also a factor helping SRC manage downturns. "I know it sounds like a cliche," Hall says, "but we really put a lot of effort into service. You generate repeat sales through service and a friendly atmosphere, and we go out of our way to give the best service we can." Part of that good service means eating warranty work on occasion. Sea Ray pays SRC its regular rate for warranty work ($ 55/hr.) but does not pay for travel time. When a boat needs repairs at a distant location, portions of the travel time and labor can wind up coming out of SRC's coffers.

Another element of the out-of-pocket costs involved is what Hall calls "policy work." This is work done to keep a customer satisfied that does not fall under a warranty umbrella. As a platinum dealer for Mercury, SRC receives the highest warranty labor rate Mercury allows, but sometimes it still does not cover expenses. Hall is quick to add that the savings he realizes because Sea Rays come pre-prepped balances out any shortfall he experiences doing warranty work. "Its not like a car dealership where they love warranty work," Hall says. "To keep our Customer Service Index at 3.7 (out of 4), we have to do non-payable repairs and eat a fair amount of labor and travel time." On the positive side, Hall makes it clear that he is very pleased to be working with Sea Ray. "Sea Ray really works with us," he says. "They look at the long term and are interested not just in gross unit sales, but in helping us to stay profitable. Sea Ray is a great company to work with."

Another big factor in Hall's success is information and support gained through the Spader 20 Groups. "We would not be here if it weren't for them," Hall says. "Over the years, they have been a consistent source of solid information." Although plans are afoot to start, SRC is not using Spader's point-of-sale system. The elements of the Spader system that Hall thinks are most helpful are the automated accounting system and the managerial information he gets from the groups.

Hall's advertising and promotional dollars are concentrated in boat shows and television ads, with lesser amounts in radio spots and the yellow pages.

In the next six months, Hall is concerned that a negative political campaign will impact boat sales. "If journalists start saying it's a bad year, boat sales will stop," he says. For the long haul, bringing new boaters into the sport is the biggest challenge Hall sees for his company. "We haven't been great at getting the entry-level

boater, but its something we are going to focus on more and more," he says. He adds that Sea Ray's new entry-level boats, the "Five Series," have been selling so well that they have had trouble keeping them in stock.

To attract entry-level boaters, Hall is planning to organize boating events. Group boat trips and fishing-and-boating seminars are at the top of his list of activities he will be offering.

"Boating is fun," Hall says. "I don't think any of us would be here if we didn't love it. When we get off work, we go out boating. Communicating that sense of fun and excitement to the beginner is the most important thing we can do. It will ensure our future."

- Justin P. Healy

Knox Marine FREDERICKTOWN, OHIO

Vital Statistics

FACILITIES: Single-location new and used boat dealership; repairs, parts and accessory sales.

EMPLOYEES: Six, including Tom Steel, owner, Betty Steel, accountant; Bob Doolin, sales manager; Steve Dalton, service manager; Michael Steel, parts and rigging manager; and Gladys Texter, accessories and tackle sales.

PRODUCT LINES: Hydra-Sports, Sea Nymph, SunCruiser. Evinrude outboards.

YEARS IN BUSINESS: 15

SALES BREAKDOWN:

New boats & trailers 70%

Used boats sales 10%

Loose engine sales 10%

Parts & service 5%

Accessories/bait/tackle 4%

F&I 1%

Birth of a grandson delayed expansion plans at Knox Marine in central Ohio this past summer. Customers who know owners Tom and Betty Steel weren't surprised by the delay. Strong family orientation and putting people first are hallmarks of this award-winning business. This attitude may sound old-fashioned, but it has been profitable for the Steel family.

"If you don't want to help people, you better get out of this business," says Tom Steel. "We have a willingness to go the extra mile to help people." It's that attitude which allows Knox Marine to win customer service awards year after year.

Fifteen years ago, the Steels purchased a tiny bait shop within sight of equally small Knox Lake. "We liked the area, so we bought a little bait shop that sold 6-horsepower outboard motors and down," he says. "We developed it into what it is today."

Steel had been an engineer for a company that developed recreational areas. Along the way, he found himself interested in tournament fishing. An ability to keep his own outboard motor running smoothly led to working on rigs owned by friends and fellow competitors.

The year 1981 was not a particularly good time to get into the boating business. Consumer interest rates exceeding 21 percent made selling new boats and motors difficult. So the Steels focused on servicing existing owners. "We started out doing mostly service," Steel says. "Then we developed into selling boats and motors."

An Evinrude sign has been hanging over Knox Marine since its earliest days as a bait shop. "Evinrude has been here for 34 years," says Steel. "Back then, we carried Landau and Smoker Craft boats. Since then, we've developed our niche, which is fishing boats. We've changed our boat lines to Sea Nymph, Hydra-Sports and SunCruiser."

Knox Marine's close affiliation with angling is natural. Nearby Knox Lake reportedly offers Ohio's finest bass fishing. But this small lake with its horsepower limitation could not support a dealership with the gross sales dollars that Knox achieves. That requires a much larger market.

"We sell over the whole state of Ohio and some states beyond," Steel says with a slight trace of bragging in his voice. He has a right to be proud. Customers don't just walk into his showroom, which is located on a dead-end country road well off the main highway. People come specifically to buy boats and motors. Many are coming to make their second or third purchase.

"We have the philosophy that everyone is equal here," says Steel. "I don't care if someone purchases a $ 40,000 new boat or a $ 2,000 used one, they're treated equally."

Fiberglass inland-lake bass boats make up the majority of units sold by Knox Marine. Even the deeper aluminum boats in the showroom are laid out for angling. The only concession to cruising comes in the form of pontoon boats displayed on the front lawn.

The showroom is best described as austere. Plain steel walls surround a bare concrete floor. There are no windows. Metal-flake gel coat on the bass boats sparkles under open fluorescent tubes. This is the sort of place where serious anglers come to buy a new rig. It's an all-business atmosphere without a trace of the world of yachting.

The Steels have targeted anglers as their primary market from the beginning. Instead of advertising in boating magazines, they chose regional Ohio fishing publications. "It's a targeting thing," says Steel about choosing a fishing magazine. "When we started, there was nobody in there except bait and tackle dealers. Now, there are eight or 10 boat dealers."

Knox Marine also appears at three central Ohio boat shows. Two are held in the state capital, Columbus, while a third is a mall show in nearby Mansfield. "We've been asked to go to Cleveland, but that's just too far away, about 120 miles," says Steel.

An inventory of 40 to 50 boats is normal for this rural dealership. Nearly all are packages of boat, motor and trailer. The majority of these are purchased outright from the manufacturers. Knox Marine uses floorplan loans for less than a quarter of its inventory. "You have to take your cash discounts in order to be competitive in today's market," says Steel.

He also takes personal charge of all warranty work: "We try to make sure that we get every warranty dollar that's coming to us from the manufacturers. That's only fair. I think that's the reason we're OK as far as what we're getting back for the amount of warranty work we do here."

Credit, with its accompanying interest cost, is not a major part of Knox Marine's business plan. "I had a mortgage when we first started here," admits Steel. "But we paid it off in a short period of time. We don't borrow to build a new building. We go as we can. That eliminates one overhead problem."

Tom and Betty Steel share a frustration that government-related costs are becoming the biggest items in their overhead. "Taxation and all of the government paperwork that we have to go through are our primary overhead," he says bitterly. "I would say that government is our biggest overhead item because we don't have a lot of other overhead."

"Going as you can" is why expansion of the facilities was delayed when son Mike announced the impending arrival of a grandchild. Steel and his wife immediately began helping prepare a bedroom for the anticipated new arrival. Work finishing the showroom and framing the new offices was halted.

"I installed the new parts counter window about a month ago," says Steel. "I still haven't had time to paint it, though."

Knox Marine doesn't completely avoid credit. The Steels visit a local bank when borrowing becomes necessary. "You have to have a local bank relationship," says Steel. "We've stuck with our local bank because they've worked with us and given us good rates. We're able to work better with them because they're local to us."

Currently, six people are employed by Knox Marine. Four of these are family. Tom is the head of the team while Betty handles the office duty. She is assisted by her mother, Gladys Texter. Son Michael is parts and rigging manager.

"We need more people, but they have to fit our philosophy," says Steel. "We need two mechanical people in our service department and one clerical person in the office. Our problem is finding the right people who will treat our customers the way we do." Unfortunately, newborn grandson Brady isn't ready to enter the family business.

- David G. Brown

Shoreline Marine DARIEN, GEORGIA

Vital Statistics

FACILITIES: Full-service dealership with two locations, one in Darien, Ga., the second in Richmond Hill, Ga.

EMPLOYEES: 8, including owner, Cleve Bennett, his wife, Kathy, and general manager Tim Howard.

PRODUCT LINES: Duracraft, Sailfish, Pro-Line/Donzi; Mercury, Johnson and Yamaha outboards.

YEARS IN BUSINESS: 24; 9 under present ownership

SALES BREAKDOWN:

New boats, motors & trailers 64%

Used boats 13%

Loose engines 10%

F&I 4%

Parts 1%

Accessories 1%

Service 7%

Cleve Bennett and Tim Howard are the kind of men you can easily picture as rowdy kids having a ball cutting up in class - and you wouldn't be wrong. Cleve's wife Kathy will attest to that. "We all grew up together in Darien, Ga.," she says. "Cleve and Tim were always playing practical jokes or throwing erasers or something in school."

Today, they are still fun-loving pranksters with the added gift of being able to make even the most outrageous story sound believable. "Cleve and Kathy knew each other from childhood and eventually got married, but all the girls back home were on to me," Tim says with a straight face. "I had to import one." A moment later they all burst out laughing. His wife, Laurel, is from Michigan.

Cleve and Tim draw on their lifelong friendship to make Shoreline Marine a successful dealership. Cleve bought the business in 1988 and this year brought Tim on as F&I specialist and general manager of the second store in Richmond Hill, Ga. Both men have a larger-than-life quality and soft "you-all" accents that inspire trust and confidence. They keep up a continuous patter of friendly banter and sprinkle their conversation with calculated good-ol'-boy jokes. But ringing loud and clear through all the jocularity is their love of boating and dedication to their business.

"We sell fun," Kathy explains. She keeps the books for the dealership as well as handling special promotions and boat shows.

"Having fun is a big part of your business," says Cleve. "And business is 100 percent attitude. A positive attitude equals a positive business." He smiles.

But the serious side is there at work. Tim puts it best when he says, "When we hit that yard in the morning, we work our tails off."

"Our main goal is to cover the Georgia coast with fishing boats," Cleve explains. "We're also planning to expand into North Florida within the year." Shoreline Marine, which started life as Townsend's Marine in 1972, was purchased by the Bennetts nine years ago to satisfy Cleve's entrepreneurial desires. A former UPS driver, he had been looking for a business to buy for several years and was also toying with the idea of owning a boat.

"His wife threatened to divorce him if he bought a boat, so he bought a dealership," Tim says. Everyone chuckles, but Kathy's laughter has an edge to it, suggesting that this joke might not be too far off the mark.

The Bennetts made the purchase with their savings and financing through the local bank. "The local bank put me on my feet," says Cleve. "It's a relationship. Every boat dealer needs a strong, progressive, smaller-town local bank. We've put a strong emphasis on debt retirement in the first years," he adds, and, in fact, they are almost in the clear.

When he took over the dealership in 1988, the business climate was good, but took a nosedive in 1989 and '90. Although the first year was bumpy, Bennett says, "I built up the business by going outside the area to vacationers and boat owners. The previous owners worked within a 20-mile radius." He points out that Darien is located in the third-poorest county in the state, on the coast in southeastern Georgia. Its residents earn an average income of $ 9,500 a year.

This is not to say that Shoreline Marine does not deal with locals. On the contrary, Bennett and Howard pride themselves on knowing almost everyone. This familiarity, they say, allows them to conduct "bidness" with a handshake. "A handshake is as good as a deposit," crows Bennett. "Even better - we don't take deposits because we trust our customers. We don't want to do bidness with someone we don't trust. At the same time, they trust us." He is quick to add that strangers may be prevailed upon to lay out some up-front money if they don't have connections to the local folk. Bennett may not be a city boy, but he's nobody's fool, either.

Bennett developed his business savvy out of necessity, he says, and he proves it through his marketing strategies. "The first couple of years, we used a lot of radio, TV and newspapers, but we found that boat shows are more effective in our area," says Bennett. "A customer can touch and feel the boat. Also, we can qualify buyers on the spot. We actually did Sam's Club shows until Genmar implemented their program. We still do six or more parking-lot shows at the X-Marts and eight to 12 boat shows a year."

For the opening of the Richmond Hill store, Kathy worked on a promotion in conjunction with a local oldies radio station to give away a new Pro-Line 150. "Listeners would call in and get a key," she says. "The winner had the key that fit the boat, but everyone who called in got some sort of prize: dinners, vacation trips. We spent a lot of money, but we built customer awareness."

Bennett admits that one of the dealership's shortcomings is failing to expand the customer base beyond the "white male boater" stereotype, but he wants to rectify that. "We're missing the boat by not taking Boy and Girl Scouts out on the water," he says. "They're our customer base of tomorrow."

Another part of their marketing strategy is the use of logos and slogans. Right now, they're making themselves known as "Georgia's most competitive dealer."

"When business is slow, we double up on advertising," Howard says. "We allocate 3 to 3-1/2 percent of gross sales for advertising," and of course, take advantage of co-op dollars. "The first 60 days in the new store, we spent $ 20,000 in advertising." He adds, "Referrals from the Richmond Hill customers are a big business. The competing dealers in our area are not very aggressive." He is clearly delighted with this latest success.

Howard comes from the RV industry, with a strong background in F&I. "We've done well enough in F&I in the last few months to cover our fixed costs for both stores," he says.

"I had done F&I, but I didn't work it like I should have," says Bennett. "Tim's expertise has resulted in 35 percent of our revenue coming from F&I."

In addition to the growing F&I segment of the business, Bennett says that Shoreline's emphasis is on volume. "We're high-volume sales driven," he explains. "We sold between 140 and 160 units last year. We use fewer manufacturers, so we gain their loyalty."

Shoreline also takes advantage of whatever the boatbuilders have to offer. "Buying programs have just come out, and we've played all the programs," Bennett says. "We buy mostly non-current models to take advantage of the programs and values."

Bennett says that the dealership is 80 percent floorplanned "so that I'm in the equity position, and I can keep a good supply of operating capital." He opened the second location without borrowing any money. He also points out the benefits of using financial statements. "An up-to-date financial statement done by a CPA is very important," he says. "We look at last year side-by-side with current statements. We also compare five-year statements."

Shoreline typically carries $ 800,000 to $ 850,000 in inventory between the two stores, Bennett says. And because their second location called for less expensive boats, they have begun carrying Duracraft aluminum boats in addition to Pro-Line and Sailfish. They are cultivating the first-time buyer and have also introduced what Howard delicately refers to as creative financing. "We work real, real hard on that," he says. When asked to explain, he says with a hint of a smile, "We don't want to divulge our secrets."

To control their costs and provide better customer service, Bennett targets departmentalizing the dealership as his biggest goal. "We have now departmentalized sales, service, rigging, and parts and accessories," he says.

"Although the employees are cross-trained, we separate the departments so we know who's accountable for good and bad jobs."

Bennett says that part of his commitment to the customer is extensive pre-delivery: doing rigger, mechanic and sales checks. They also water-test all products to ensure safety. "We take a little extra time on pre-delivery, and if there is a small problem, the customer knows we really checked it," he explains. "We're able to build that time into pre-delivery charges. We take the time and build the customer's confidence with that."

Bennett has also structured the payroll so that everyone is on commission. He says that up until a year ago, he had employees on flat salaries to prevent customers from being overcharged, but he didn't get satisfactory productivity. Once he put in incentive programs, he says, he gave them a reason to perform. Sales are paid strictly on commission, but he claims to pay a higher-than-average rate, so he draws only highly motivated people and has a low turnover.

Service technicians are now paid commission on labor only, and nothing on parts. "It's helped 100 percent," Bennett says. "Production levels have tripled. The workers like it because they have the opportunity to make a lot more money than before, and it's kept me from having to micro-manage everybody." He explains that the profit he makes from referrals is more important than selling, say, $ 400 worth of parts to a customer and ruining a relationship.

Bennett has strong opinions on the subject of service in his dealership. "We don't put an emphasis on making a profit in service," he says. "We use service as built-in advertising. Why jeopardize price-point perception to make $ 50 or $ 75? A lot of dealers are so aware of each item and they itemize it for the customer - the customer doesn't want to know. Get the big picture," he barks like a JV coach to his team. "Don't bring more grief on yourself with small details. Service is my biggest closing tool."

Shoreline Marine also uses direct marketing tools to keep the dealership's name in the customer's mind. Three letters go out to new owners, starting with a pre-delivery/orientation letter telling purchasers such things as when to expect serial numbers and whether parts can be added later on. The second "helpful hint" letter details the 12 most common problems seen by the service department so that these problems can be headed off. An extensive operational and safety letter follows.

Bennett says that carving either a high-volume or a service niche is the way to go for the future. "Dealers need to position themselves as one or the other," he emphasizes. "The ones who pick their path will be successful. You can be either a service- or a sales-oriented dealer, but not both. I'm a sales-oriented person."

- Liz DeFranco

Monterey Marine SAN JUAN, PUERTO RICO

Vital Statistics

FACILITIES: Full-service dealership and accessory store with two locations, one in Plaza las Americas mall in San Juan, P.R., the second in Villa Marina Shopping Center, Fajardo, P.R.

EMPLOYEES: 15, including owner Julio Fernandez and general manager Carlos Latur.

PRODUCT LINES: Monterey, ProLine/Donzi, SeaPro, Bayliner, MerCruiser, Volvo Penta, Mariner outboards.

YEARS IN BUSINESS: 5

SALES BREAKDOWN:

New boats, motors & trailers 60%

Used boats 10%

Loose engines 8%

F&I 2%

Parts 5%

Accessories 5%

Service 10%

Before 1991, Carlos Latur couldn't tell you the difference between a sailboat and a johnboat. Instead, he was the Good Humor man of steaks and chops, selling meat out of a truck to hotels in Puerto Rico. Then his best friend, Julio Fernandez, made him an offer he couldn't refuse.

In the late '80s, Fernandez and his father owned a small chain of auto parts stores. Julio, who was a boating enthusiast, purchased a used boat for himself in Miami and brought it back to Puerto Rico with him. He fixed it up so well that someone offered to buy it from him. He turned his first boating profit, and thus began a small used-boat business.

In 1991, Fernandez attended the Miami Boat Show and saw Monterey Boats of Archer, Fla., "hiding in the corner." He connected with the company's salespeople at the show and that year introduced the boats as his first line in a new dealership, naming the business Monterey Marine in honor of the boatbuilder.

As he turned his attention to his fledgling marine business, Fernandez realized that he could no longer run the three auto parts stores in addition to the boat dealership without help. So, leaving his father in charge of the car parts business, Fernandez asked his old buddy Carlos Latur to help him in his marine business.

"About that time, the meat business went bad," says Latur. "Hotels were going into bankruptcy. Julio was looking for someone to work with him in boats. I didn't know anything about them. I had been a passenger in Julio's boat, but that was it." He laughs.

But Latur had a college background in business and practical experience in sales behind him. "Julio sold the boats, and I took care of the store," Latur says. He also took himself to Florida for a one-week MerCruiser training school to learn to service sterndrives.

Latur and Fernandez's families both emigrated from Cuba when the two were children. Latur arrived in Puerto Rico when he was about two, Fernandez at eleven, after living a couple of years in Spain. As young men, Latur's girlfriend - now his wife - was Fernandez's neighbor, and the two met that way and eventually became close friends.

"Somos 'gemelos'," Latur says, using the word that means "twins" to describe his relationship with Fernandez. And just as the two are versatile in language, switching back and forth from Spanish to English - sometimes even in the same sentence, falling into the "Spanglish" speech pattern characteristic of many people who live in Puerto Rico - they use their flexibility to great advantage in business.

"If a guy places an order with me and he needs me to take the merchandise to his boat or his house, I take it to him," says Latur. "At the delivery, we talk, we're friends."

Monterey Marine has a three-pronged business philosophy based on price, service and personal relationships. "I can give you a better price than the competition," Latur emphasizes. "I try to make the customer

happy, to give good service, and be friends with the customer. The main key is to keep the customer happy. If you do that, you can get him to trade up, and to buy his new boat from you."

This practice has been extremely successful. For two years, Monterey Marine made its home in a small location in San Juan, moving three years ago to a larger space in the nearby Plaza las Americas shopping center. A second location in the Villa Marina Shopping Center, about an hour away in Fajardo, was also added. The Fajardo facility had been only an accessories store, but boats were added this July. As business has grown, Pro Line/Donzi, Sea Pro and Bayliner have been added, along with MerCruiser, Volvo Penta and Mariner outboards. Including the partners, the employees now number 15, four of whom work in the service department, with another four in sales and two administrative staff.

The dealership brings in customers through newspaper ads, taking advantage of the boat companies' co-op dollars. Distributed at boat dealerships throughout the Caribbean, a free newspaper called the Tropic Times is Monterey's primary advertising vehicle. In it they promote specials on accessories such as spark plugs and oil. During the slow months, Fernandez will also place classified ads for boats in the island's largest newspaper, San Juan's El Nuevo Dia.

Monterey Marine's customers range from Puerto Rico residents to military personnel stationed at Roosevelt Roads Naval base, 15 minutes from the Fajardo location, to inhabitants of nearby islands. "The base has a marina, so we sell boats and parts to the military and their families," says Latur. "And sometimes people on the other islands pick up the Tropic Times and call us to order parts. We ship to a lot of customers on other islands.

"The yellow pages brings in some business, but the newspapers work better," says Latur. "The Miami Boat Show has also been real good. We sell 15-20 boats there. We've gone there for four years. Everybody waits for the boat shows because they give specials," he adds. "We used to go to IMTEC, but we haven't gone in two years. It's been too busy to go. We don't have time for anything. Business has been real good."

Business has been so good that their current boat inventory of 15 units is low. "You never can have a full line," Latur says somewhat mournfully. "You try and you try, but..." Keeping up with demand is futile he conveys, not unhappily.

One venue that has not yet been successful for Monterey Marine is mall shows. Although they have arrived in Puerto Rico, the dealership sold only one boat at a week-long show in Ponce. "Malls are too small," says Latur flatly.

For a marine business, it is ironic that one of Monterey Marine's biggest difficulties is shipping. Although Puerto Rico is part of the U.S., dealers located on that island are often lumped in the "foreign" category by boatbuilders and distributors and serviced by their "export" divisions. The reasons have more to do with geography than anything else because it is more expensive and takes more time to send to locations not on the mainland.

"Ocean freight takes a long time," Latur points out, "one month usually, sometimes less. A boat arrives once a week from Miami with accessories and parts. It's expensive to ship via UPS."

Aside from the freight challenges over which reps and distributors have no control, Latur finds the companies he does business with to be helpful. "If a boat or accessory arrives with problems, they try to send replacements immediately," he says. "They provide good service." But he chooses his distributors with a shrewd eye toward the bottom line. "I work with pricing and the one who gives me more time to pay," he says simply.

For the most part, Monterey Marine is satisfied with its suppliers, but, like many dealers, Latur thinks that warranty issues could be resolved better. "Siempre problemas with labor and job reimbursements," he says. "Always problems. We're slow in getting credited on our account. They're all the same," he sighs.

Monterey Marine's two biggest struggles with expenses are payroll and telephone charges, according to Latur. "Salary is just..." again, he is at a loss for words to describe his overwhelming payroll. "And the telephone - whoo! Mucho money," he says. It is long-distance to call between the San Juan and Fajardo locations, and Latur says, "I can make 35 calls a day."

However, Latur and Fernandez are able to meet these challenges and triumph, expanding their business and broadening their customer base. "The next five years won't be easy for boat dealers," Latur concedes. "You just have to work with the customers and keep them happy. If you don't, you won't last long. Believe me - I hear customers complain to me when my competition doesn't treat them right."

- Liz DeFranco

Glencove Marine Sales & Service LAKE OZARK, MO.

Vital Statistics

FACILITIES: Full-service dealership with marina and accessories store on the water in Lake Ozark, Mo.

EMPLOYEES: 27, including co-owners Ron Thompson and Willie Sieg; 11 of them are in the service department.

PRODUCT LINES: Duracraft, Sailfish, Pro-Line/Donzi; Mercury, Johnson and Yamaha outboards.

YEARS IN BUSINESS: 13

SALES BREAKDOWN:

New boats, motors & trailers 66%

Used boats 14%

Trailers 2%

F&I 1%

Parts and Accessories 7%

Service 5%

Storage, mooring and boat rental 3%

Fuel 2%

The first thing Ron Thompson will say about Glencove Marine Sales & Service is that it is not in Arkansas.

"Because the name of the town we're in is Lake Ozark, people think we're in Arkansas," Thompson, co-owner of the dealership, says. "But we're not in the Ozark Mountains in Arkansas; we're on the edge of the range in Missouri. The area is not the 'Lil Abner' Ozarks many people picture. It's an upscale community and summer destination. People take offense at the area's being called the Ozarks," Thompson warns.

The lake itself is actually a 130-mile-long reservoir formed in the Osage River by Bagnell Dam. According to Thompson, 75 miles of the lake is navigable for boats, the first 25 miles hosting all the boating activity.

Thompson describes the lake as a second-home community. "Second homeowners are 75 percent of our customers - they vacation during the summer," he says. "The people who do a lot of boating do it year-round. The wives and kids spend the summer, but after school starts they do come back. The lake is most gorgeous in October."

Thompson ought to know about the the lake's vacation-home residents: he was one himself. Until the early '80s, he was a service-station owner who lived in Bloomington, Ill., and spent leisure time at the lake. But in 1983, he and Dan Smith, another part-time resident, decided they wanted to enjoy the beauty of the lake year-round, so they bought a resort that did not have a marina and built one "from the ground up".

"The business climate was good in 1983, with steady growth at the lake," Thompson says. Although the dealership started by carrying the Chris-Craft line, they added Formula soon thereafter. Thompson reports that this year Formula is his highest-volume seller. Glencove added Trojan this year "because they make bigger cruisers - up to 44 feet, and they go into flybridge models," says Thompson. "We wanted to give our customers with 'two-foot-itis' somewhere to go after 38 or 40 feet."

Thompson also does a substantial portion of his business in personal watercraft sales: Glencove was Tigershark's biggest Midwest dealer for the 1995-96 year. He says his PWC experience has shown that contrary to popular theory, "PWC owners do not become boat owners - it happens the other way around. Boat owners get another toy for the kids to play on. Boats have become bigger and more powerful," Thompson points out. "They're not for family water sports anymore. That's why they get PWCs: so Dad can send the kids out on a $ 6,000 PWC instead of a $ 75,000 boat."

Glencove keeps an average of 35 units in the summertime, three or four of them being non-current. They watch their inventory fairly closely, Thompson says, the result of a painful lesson in economics learned several years ago. "We sold off a lot of our inventory three years ago and took a big hit on it," says Thompson, "so we learned to stay on top of it. The floorplan companies allowed us to slide on the curtailment program for years. It became cheaper to pay floorplan on the inventory than to sell it. We couldn't afford to sell it."

At the same time that Thompson was biting the bullet on his inventory, Glencove was undergoing ownership changes. Thompson bought out his partner, Dan Smith, and became the managing partner. Willie Sieg joined the business.

Today, Thompson says, Glencove floorplans 90 percent in order to increase its cash flow. The dealership uses Bombardier, Deutsch and TransAmerica. "All three companies have been good," Thompson says. "We use the pre-sold program a lot: a customer-sold boat put on the floor that gives us 30 days to take delivery of the boat, deliver the boat and get it paid fast. It doesn't affect the floorplan - that's a different deal completely," he points out. "Deutsch has been very aggressive on that. We do a lot of pre-sold units because people want what they want on the boat. You don't say 'no' to a guy who's spending all kinds of money on a boat. You give him what he wants."

To keep customers of his high-end products satisfied, Thompson promotes value and service over price. "We have a superior product for the dollars," is how he describes his dealership's niche. "The customer is getting a good value for products we sell," he emphasizes. "Also, it all goes back to service of what you are selling. Service is our greatest strength."

In the spirit of providing ever better service, Glencove is increasing its facilities. The land around the dealership is being cleared to make room for new structures, and new aspects of the business are being added. While the sales office, convenience store, Tigershark PWC building and the shower and lounge provided for

storage customers are located on the water, the current building housing rack storage and the service shop, as well as the building in which parts and accessories are sold, are located away from the lake. "They're way back on top of a hill, about a quarter of a mile away," Thompson says. "Boats have gotten so much bigger in the last 13 years since we built the service building that it's become cumbersome to bring the boats up."

Next fall, Thompson anticipates the completion of the new structures. In the meantime, the convenience store has been combined with the accessory store and is located on the water with the gas dock. He is converting what used to be the convenience store into a boutique for logoed items. "It's very popular, and it's a good business," he says of the Tigershark, Trojan and Formula-wear he has ordered. "We've never had the square-footage to display the logoed merchandise before." Thompson's wife, Janice, chooses the accessories and logo-wear.

Just as the boat companies advertise their brands with their logoed items, Thompson knows the importance of getting his dealership's name in front of the public. In his attempt to broadcast the Glencove name, he has found that television and the Internet are not the most effective methods. Instead, he concentrates his efforts on newspapers, radio, direct mail and billboards. "We have free marine newspapers in our area that are widely used by the consumer," he says. "We advertise in them. We're also very big on radio." As for the yellow pages, the jury is still out. "Does it work?" he asks himself. He considers for a moment, then answers candidly: "I don't know. We have a quarter-page ad more as a service so already-established customers can find us than for new boat sales."

On the other hand, highway signboards seem to be the way to go for Glencove. "Billboards are the most cost-effective," Thompson says. "They draw more customers in. We have five on three-year contracts, and they're staggered so we get a new sign every year. On two of our local boards, we have changeable ad strips, which are something new in the billboard industry." The changeable strips allow Glencove to display different messages on a constant background. "We do this all the time," Thompson says.

He also finds that rather than mall shows, boat shows bring in the business for Glencove. "Saint Louis, Kansas City and the local boat show at Easter are all effective," he says. "We use every penny of co-op, too. The companies ought to build another percent or two into this program," he suggests. "There should be more lucrative programs there. Dealers should be able to get 75 to 100 percent back for special uses."

While he feels that boatbuilders could support dealer efforts a little better, Thompson points out that one of the biggest problems in the industry is the issue of protected territory. "Boat companies can't keep dealers from advertising out of their markets, although the dealers aren't supposed to," he says. "It goes back to setting up good, solid dealers. The boat reps walk the same fine line as the dealers - their hands are tied, but they do what they can."

On the other hand, he says boat manufacturers' dealer agents are "terrible" and feels somewhat left adrift by them. "With the investment a marina makes to develop clientele for the product, we get nothing more than a dealer contract," he says. "We have no protection at all that we will be the dealer for a given line next year. They could change it on a whim."

Engine companies could also stand to make some improvements, Thompson finds. "When manufacturers have a problem, they need to belly up to the bar quicker to take care of it," he says. "MerCruiser's the greatest one to say, 'Oh, we've never had that happen before.' It wastes a lot of time trying to figure out what's happening when there's a flaw in the engines. It takes us a lot of extra time trying to diagnose the cause."

For his part, Robert Bonev, MerCruiser's director of business development and strategic planning, counters that his company has an excellent record of dealer support. "Being the preeminent supplier of marine engines for pleasurecraft worldwide, we handle 200,000-250,000 telephone calls per year about both dealer and customer issues," he says. "We know there are some problems, but we're constantly working on resolving them. We stand by our record in supporting both our dealers and the retail customer."

Thompson feels that he gets better protection than his counterparts in other areas because of certain state statutes favorable to dealers. "Missouri is one of the few states that requires reimbursement at normal shop rate for labor under the law," he says. "The companies nickel-dime you on how long it should take, but that's part of the cost of being a full-service dealer," he adds philosophically.

Thompson leaves it up to the customer to decide how much warranty coverage is necessary. "How much warranty does the consumer want to buy?" he asks. "I like to leave after-market warranty as an option for the customer to decide on."

He may allow the customer to make a decision on the amount of security he wants to purchase, but Thompson knows that providing good service is pivotal to staying in business. "With a short season, boating has got to be enjoyable," he says. "People don't have to have a boat. When boating becomes a pain, they'll be gone," he emphasizes.

The long-term future of recreational boating looks bright to Thompson. "Boating is here to stay," he says. However, he is alert to aspects of the industry that bear close watching. "Insurance will become a big factor in what will sell, especially in personal watercraft," he predicts. "Laws will be important in the next few years. Look at the activity that's already taking place to control PWC. They're totally restrictive in some areas."

On the other hand, his outlook for the next year-and-a-half is not all sunshine and glee. "Our low-end, entry-level, less expensive boats (23 feet and down) have been soft this year already," Thompson says. He offers other dealers some practical advice: "You'd better rat-hole some money."

RELATED ARTICLE: Putting all the profiles together

The preceding pages contain individual profiles of boating businesses that are leaders in the industry and in their communities. For an aggregate look at boat dealers, you can turn to the U.S. Bureau of the Census and other data sources. Using these sources, BOATING INDUSTRY has developed the following national "profiles" of various aspects of the U.S. retail boating business:

* In 1992, the latest year for which federal statistics are available, the nation had 4,773 establishments classified by the U.S. Bureau of the Census as "boat dealers." Many of these dealerships were no doubt among the 7,454 retail marina, boatyard and docking operations estimated by the National Marine Manufacturers Association (NMMA) for 1995. BOATING INDUSTRY estimates that in 1995 there was a total of 10,000 marine retailers, 8,000 of whom were boat dealers.

The 4,773 businesses classified by the census as boat dealers had total 1992 sales of $ 5.54 billion, for average annual per-establishment sales of $ 1.16 million.

NMMA estimates that in 1994, Americans spent about $ 6.7 billion on a combination of boats, outboard motors, boat trailers and marine accessories.

* Although Michigan has been the leading state in boating registrations, the census found that Florida also led the nation in number of boat dealers (587) at the end of 1992. California was second with 313 and Texas

third with 245. Sales reported by boat dealers in 1992 were highest in Florida, with $ 814 million, followed by Michigan at $ 389-million and California at $ 385 million, according to the census.

* About one-fourth of the boat dealers counted by the census reported receipts from pleasure boat storage and docking services. The average dealer took in $ 68,484 for such services in 1992. Dealers also took in an average $ 31,000 in boat rentals. Sales of parts used in repairs by these dealers averaged about $ 67,831.

* Among the various retail sales categories, the typical boating retailer was more likely to sell an outboard boat and/or outboard motor than any other type of craft and/or engine, according to NMMA figures. It estimated 1995 sales of 231,000 outboard boats and 317,000 outboard motors. Sales of personal watercraft, at 200,000 units, and boat trailers, at 207,000 units, were also among the larger categories in 1995. Also estimated by NMMA were sales of 120,000 sterndrive and inboard engines, 93,600 sterndrive boats and 12,360 inboard boats. Total retail sales of all boats was estimated at 649,460 units in 1995.

* NMMA estimates that Americans spent about $ 17.3 billion at retail on boating in 1995, a figure that includes spending on new and used boats, motors and engines, accessories, safety equipment, fuel, insurance, docking, maintenance, launching, storage, repairs and club memberships.

- Tom Williams

Assistance with this article was provided by Barbara Haimowitz, research director for National Trade Publications, Inc., publisher of BOATING INDUSTRY.
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HEADLINE: Downtown kinder to buyers than renters Condos priced to please but rentals are pinched

BYLINE: By Andrea Gordon Special to The Star

BODY:

The song may be dated, but many Toronto residents still believe Petula Clark's lyrics that there's a place to be, and it's Downtown.

These days, however, anyone wanting to live in the heart of the city had better think about buying.

Downtown realtors say a tight market has pushed the vacancy rate below 1 per cent, pushing up prices and making it next to impossible to find apartments and condominiums to rent.

On the flip side, falling interest rates, a rash of new condo projects and a sluggish real estate market make it a good time to shop for a home in the city centre.

Actually, residental real estate suddenly went great guns last month, recording the busiest May in a decade for sales of existing homes.

There were 5,514 home sales in the Greater Toronto Area, up 46 per cent from May of 1995. It was real estate's busiest May since 1986, which just happened to be the GTA's busiest year on record.

Property lawyer Alan Silverstein wrote in The Star's New In Homes section yesterday, "From all indications real estate hit rock bottom in February and has been slowly climbing ever since."

The recent spurt, however, comes in the face of a long stagnation in Metro property values across the 1990s. Today's condo prices seem out of whack with the cost of renting a unit of the same size.

"It's virtually as easy to become an owner as to become a tenant," agrees realtor Hunter Milborne, a player in downtown condo sales.

He says anyone with a $5,000 down payment for a condo can probably end up paying less per month on a mortgage than they would on rent for a similar unit. A number of units are available at all price ranges throughout the downtown core, he added.

Projects such as the 185-unit Camrost Development beside the St. Lawrence Market offer prices starting at $79,000 for a studio and ranging up to $200,000 for the largest suite.

Another realtor, Pat Baker, says a host of new projects - including the now trendy conversions of offices and warehouses into homes - means a variety of newly constructed suites is on the market.

Pat Baker Real Estate is handling sales of the new project at One Avoca Ave., near Yonge and St. Clair, and Baker says quick sales there and at several nearby new developments prove there's a demand for high quality homes in central locations.

"Hundreds of units have been absorbed at Yonge and St. Clair alone over the past two months," she says.

Julie Di Lorenzo, in charge of sales at nearby One Balmoral, which begins construction this summer, says that project sold almost all its 130 units six months before expected.

The Opera Place at Bay and Wellesley Streets, a rare new downtown site, began selling last fall and is already marketing Phase 2. T he development will eventually have 1,000 units starting at about $90,000 for a studio.

Di Lorenzo and others say two groups are responsible for renewed interest in the city - aging baby boomers who want to downsize from family homes while keeping the conveniences of downtown, and young professionals who would rather invest in their own property than pay out hefty rents.

Steven Fudge of Bosley Real Estate believes that those demographics, plus a rental market that is expected to remain tight, will eventually lead to a booming downtown condo market.

And with a finite amount of space available for new projects, that will mean more interest in unique conversions, adds Fudge.

Recent examples of conversions are the Candy Factory, a former warehouse on Queen St. W. with 120 units; and The Metropole, a former office building with over 300 units at King and Yonge Sts.

Fudge predicts the rental market will stay tight because many who are downsizing are selling their homes first and renting while they decide what to buy, or are waiting for construction of condos they've already purchased. At the same time, the likelihood that the Mike Harris Ontario Government may loosen rent controls doesn't bode well for those seeking affordable rental housing.

'There is still an unwillingness to put money down'

Because of the low vacancy rate, people who buy condos to rent them out can probably cover their mortgage costs, which they couldn't do in the late 1980s and early 1990s.

But the factors that make buying a logical move still aren't prompting people to get into the market, says Harry Stinson of Stinson Real Estate. He says the continuing lack of job security and economic uncertainty are still causing potential buyers to take their time.

"There's a strong demand to live downtown, and the vacancy rate is indicative of that. But there is absolutely no sense of urgency. There is still an extraordinary amount of insecurity and unwillingness to put money down."

Fudge, however, predicts that will change as the market starts to absorb the many new projects that have come onstream.

See related story by Honderich on page LL1. Lifestyles is a free supplement, delivered to condominiums and apartments, consisting predominantly of condensed versions of Star stories. Only original stories appearing in this section will be contained in ALIS.
GRAPHIC: 2 photos: NOW AND THEN: Two Hundred Clinton Street (above) near College St. is now home, sweet home to 13 residential units, with only one still unsold. The new look is the result of a complete makeover of an abandoned factory site (below) that, for long years, produced buttons for the needle trade. (Page LL2)
LOAD-DATE: March 4, 1999

Evidentiary Exhibit Number 168

Chicago Tribune

May 31, 1996 Friday, NORTH SPORTS FINAL EDITION

SECTION: YOUR PLACE; Pg. 3; ZONE: C; Homes. Where to look. What to buy. How to borrow.

LENGTH: 1338 words

HEADLINE: CABIN FEVER;

IS YOUR POCKETBOOK READY FOR A VACATIN HOME?

BYLINE: By Marilyn Kennedy Melia. Special to the Tribune.

BODY:

The easy-living summer season is officially underway. And, many Chicagoans who flee their usual surroundings for a holiday will be tempted to give that easy-living feeling more permanence by buying a second home in their favorite get-away location.

Research shows more of us are musing about our own cottage by the lake or house on the beach. According to a 1995 survey by Ragatz Associates, a consulting firm in Eugene, Ore., some 60.3 percent of households surveyed indicated they have a chance of purchasing a second home during the next 10 years, up from just 25.5 percent in a 1990 survey. Consultant Richard Ragatz theorizes that the increased attention to vacation properties is prompted by the aging of the Baby Boom generation, and improved mortgage interest rates and economic conditions.

But because a primary home is most people's biggest investment, it stands to reason that buying a second home also has a big impact on one's finances. If you're contemplating buying a vacation home, here are some of the more serious considerations involved.

Is it affordable?

Northfield financial planner Ellen Rogin suggests that you look beyond the immediate pleasures a second home can bring, and consider what your long-term goals are concerning this property. "When you are making a decision about buying another home, you should also do some retirement planning at the same time," Rogin advises. If you are putting all of your money into both your primary and secondary residences, and neglecting or curtailing contributing to a retirement fund, Rogin says you're apt to regret it when it comes time to start living off a 401K or other retirement plan.

"However," notes Rogin, "if you are adequately funding your retirement and you do have extra money for a second home, it can make sense financially." Rogin adds that some people buy a second home with the idea that they will then sell their primary home when it comes time to retire, reaping all the money they'll need from the sale. That plan may be fine, says Rogin, as long as you really are prepared to sell your Chicago residence. All too often, what looks good on paper is very difficult to enact in reality, and retirees can regret having to sell their home of many years.

When you're seeking a mortgage loan for the vacation home, the lender won't be advancing you the funds if the second mortgage puts too much of a strain on your income. As a general rule, says Suzan George, loan officer with North Shore Mortgage, Winnetka, the payments you'll make on both your primary and secondary mortgage, as well as your payments on car loans and credit cards, shouldn't exceed 38 percent of your gross (before tax) monthly income.

And while mortgage payments and property taxes are the biggest outlay for a second home, buyers shouldn't forget to factor in maintenance costs, warns Bob Starr of Starr Realty, Sturgeon Bay, Wis.

All of the chores you must tend to in your primary home will also be waiting for you at your getaway place. Lake Forest resident Rick Shimp says it takes about an hour to mow the lawn at his summer home in Door County, Wis. Because he'd rather spend his valuable weekend time enjoying activities with his wife and children, rather than cutting grass, he has locals do the job for him. The good news, notes Shimp and others, is that labor costs in many vacation spots are lower than in the Chicago area.

Tax benefits

If you're failing to fund a retirement and having to skimp on other areas, "it doesn't matter what tax benefits you are getting from your second home," notes Rogin.

But for those who can comfortably foot the bills for a second home, the tax considerations make a vacation home that much more pleasurable. Specifically, says accountant Craig Lofgren of Lofgren & Lofgren in Lake Forest, you can deduct the mortgage interest on both your primary and secondary residences, as long as the mortgage loans on both properties don't exceed $1 million. You can also deduct real estate taxes on both homes, regardless of the size of your mortgages.

To rent or not

Some buyers may plan on renting out their home, figuring that rental income will help them pay the bills on their property. If you're carrying a substantial mortgage on the home, however, you may find that rent will hardly help you carry the load. "Prices on homes here are almost too high to allow you to expect rent to pay the mortgage and taxes," notes Lynda Holmes, broker-owner of Century 21-Frank Smith Realty, Saugatuck, Mich. What's more, if you do decide to rent your property, you must be prepared to keep meticulous records for the IRS.

However, notes Lofgren, homeowners can rent their property for up to 14 days without reporting the rental income to the tax man. (This tax break may not be around indefinitely, however, because it is targeted for extinction in current tax negotiations in Congress.)

If you do plan to rent your home more than that, you should make sure your personal use of the place is kept to 14 days, or 10 percent of the number of days it's rented, whichever is greater. If you keep your use under that threshold and you actively manage the place, then you'll be able to deduct a pro rata portion of expenses--costs such as maintenance, depreciation, utilities--from your wage income and rental income. However, the IRS only allows you to fully deduct these expenses if your adjusted gross income (your taxable income) is $100,000 or less, notes Lofgren. Deductions gradually disappear until your adjusted gross income reaches $150,000. If you're earning more than that, your rental expenses can only be applied to reduce taxes on rental income.

Needless to say, renting a vacation home opens up a complex set of tax rules. Prospective home buyers should probably consult an accountant if they want to determine whether renting makes sense for them financially.

Will you use it?

One of the reasons Chicagoan Michael Noone selected the south end of Door County for his recent purchase of a vacation home is that he can leave his Wicker Park home on Chicago's Near Northwest Side on a

Sunday evening and be at his cottage within a reasonable time. "I work on weekends so I can go up on a Sunday and come back on a Wednesday when traffic is minimal."

Indeed, how much travel time it takes to reach a vacation dwelling, as well as how much time off you can spare to visit, are key considerations in determining the feasibility of a second property.

"A lot of people who own second homes are in a position to take three-day weekends when they want to," notes Saugatuck real estate broker Lynda Holmes. Adds Jeff Glesner of Glesner Realty-Better Homes and Gardens, Sturgeon Bay: "Many buyers are business owners who can make their own schedule."

Appreciation

Shimp is probably typical of most vacation buyers in that he views his purchase as dollars spent for pleasure, not investment. However, if he winds up making money if and when he decides to sell, he notes that's not a bad side benefit.

Experts say that buyers shouldn't make the second home purchase with the primary objective of seeing the property appreciate. Home prices have escalated at a very uneven pace all over the country, and prices in vacation spots are particularly unpredictable.

However, John Tisdall, president of Coldwell Banker-Geneva Lakes in Lake Geneva, Wis., notes that some of the same maxims involved in selecting a primary residence also play into the future resale of a vacation home. "It's the same old principle--location, location, location," says Tisdall. "If you buy a waterfront or water-related property--a home with a boat slip or a place that has parkfront access to the beach," values are more likely to increase due to buyer demand for these scarcer sites.

But a vacation home is ultimately a very emotional purchase, notes Tisdall. "People first fall in love with an area on a visit. Then they decide that they must have a place there."
GRAPHIC: PHOTO GRAPHICPHOTO: (Log house.); GRAPHIC (color): On the cover. Illustration by Dave Calver.
LOAD-DATE: May 31, 1996

Evidentiary Exhibit Number 169

Ethnic NewsWatch
Emerge
April 30, 1996

SECTION: Vol. 7; No. 6; Pg. 47
SLI-ACC-NO: 0696EGLR 030 000016
LENGTH: 3891 words

HEADLINE: BUILDING WEALTH
BYLINE: Boston, Kevin
BODY:
BUILDING WEALTH.

ONLY 7.5 PERCENT OF AFRICAN AMERICAN households earn 50,000 or more. These households represent African American families with the most ability to control their financial destinies. Their income allows them the opportunity to reach many of their financial goals. They have the financial resources to send their children to college, make a down payment on a home, and retire with financial dignity. While many African American families in this socioeconomic group obtain these financial goals, recent findings indicate that far too many do not.

Many African American households in this high-income bracket experience the same money management problems faced by the majority of African American families, who on average earn 21,162. These problems include the inability to save a portion of their income, plan for their financial future, invest in appreciating assets, control their income tax obligation, fight inflation, and find reasonably priced insurance.

As a result, lower- and middle-income African American families commit the greatest financial error that they can make: they fail to substantially increase their net worth over time. If their financial goals are met, it is due in part to the support of a family member, a subsidy check from the government, or a lucky break. Hence, both lower- and middle-income groups need to develop a financial strategy that will help them obtain concrete financial objectives.

An important aspect of the net worth-building program is its reliance on utilizing resources the African American community already controls. These resources include our income combined with our human resources, that is, our intellectual, physical and spiritual capital.

By pursuing a strategy to increase their family wealth, African Americans can also control their economic destinies and reach their financial dreams. Here are seven smart money moves to help do just that.

1. CREATE A WEALTH-BUILDING PLAN A wealth-building plan is a financial plan in which the major goal is to increase a household's net worth to 200,000

to 250,000. Unlike most financial plans that center on a specific lifestyle goal -- a vacation, new home, or retirement -- the wealth-building financial plan goal is to increase the household's net worth. Additionally, while the net worth goal timetable is ten to fifteen years, the wealth-building plan is a lifetime plan.

2. INVEST IN YOUR DREAMS EVERY PAYDAY Mark and Jo Ann Skousen wrote in High Finance on a Low Budget, "Saving must become an immutable rule in life." According to Mark, who has also appeared on my The Color of Money TV show, "Saving must come first, before the rent, before taxes, even before food for the baby."

3. OWN YOUR HOME "Most Americans count their home as their most valuable possession, but segregation means that African Americans build less home equity," reported Farai Chideya in her book, Don't Believe the Hype: Fighting Cultural Misinformation About African Americans. Additionally, many African Americans who do own homes do not view them as investments. Therefore, few African Americans are willing to use their homes as equity to purchase other homes that may be appreciating faster. Our reluctance to use our home equity to purchase higher priced homes limits our ability to increase our net worth. Nevertheless, given the tax benefits and the opportunity for appreciation, home ownership can be a powerful tool in creating wealth.

4. INVEST IN THE STOCK MARKET Historically, investing in stocks has provided an average return of 14 percent annually. The investment with the best return over an eighteen-year period was large company stocks, producing an annual compound return of 14.21 percent.

5. INSURE YOUR DREAMS In Don't Believe the Hype, Chideya states, "Due to factors ranging from violence to poor access to health care, African Americans live an average of six years less than whites." This statement illustrates the need for African Americans to understand how to protect our financial dreams, using low-cost term-insurance and disability insurance plans.

6. OWN A BUSINESS ENTERPRISE One of the most alarming situations today is the small number of African American entrepreneurs. At last count by the U.S. Bureau of the Census, this number was less than 425,000. This fact is alarming because few African Americans can make vast fortunes without owning a business. Today most millionaires are not born, they are self-motivated, hardworking entrepreneurs.

7. MAXIMIZE YOUR HUMAN RESOURCES We also have access to an enormous amount of intellectual, physical, and spiritual capital. For various reasons we have historically undervalued and underused our human resources. Consequently, once we understand how to maximize our human capital, we will be able to reach our net worth goals sooner.

INVEST IN A HOME

Home ownership can help many African American households increase their net worth. In the plan to increase your net worth to 200,000, about 50,000 to 75,000 of this total may come from the equity you build up in your home over the years. Let's consider for a moment all the money you can pay to rent a home.

The primary issue is whether to invest in your own home or invest in someone else's. Most financial planners will tell you that it is best to own your own home. After seven years it does not make good economic sense to rent.

Now let's suppose that ten years later you want to send your child to college, retire, or buy a business. Can you ask your landlord for a loan or to return some of your rental payments? No. However, if you owned your home, you could use a portion of the equity to finance your endeavor. If you decide to sell your home, you can make money (capital gains, which are profits taken by selling capital assets for more than they cost) but once you leave a rental unit, you take nothing but your belongings.

Most of America's wealth is tied up in real estate. However, a 1990 report by the U.S. Bureau of the Census states that "More whites realize the dream of owning a home than African Americans. Forty-two percent (42%) of African American households own their homes, and fifty-six percent (56%) rent; by contrast, sixty-seven percent (67%) of whites own their own homes."

You can deduct the interest on your mortgage payment, as well as local property taxes. In addition, as you pay down your mortgage, you can watch your equity accumulate.

INVEST IN THE STOCK MARKET

Every year millions of Americans increase their wealth substantially because they own stocks and securities. In the May 1, 1995, issue of Newsweek magazine, a story entitled, "A Rising Tide Lifts the Yachts," explained how various investments help to widen the wealth gap between rich and poor Americans. The article pointed out that "The United States leads the industrialized world in its inequality of incomes."

Sharing the results of a study by economist Edward Wolff of New York University, the article stated: "The wealth of the richest 1% of U.S. households climbed from 20% of all stocks, bonds, savings accounts, home equity and other private assets in the mid-1970s to 35.7% in 1989. The haves have more now than at any time since 1929."

A Bureau of Census report states that while the average white household owns 3,420 in stock mutual funds, the average African American household owns 115 in these investments. Furthermore, while the average white household shows interest earnings of 7,308 a year, African American households' interest earnings are only 872 annually.

There are numerous reasons why we have not routinely invested in the

stock market. None justifies losing the wealth building benefits of one of the world's greatest wealth-building tools -- shares in growing companies. In many ways owning stocks in a growing company offers the same type of rewards as being an entrepreneur. The basic difference is that instead of running the business, you are an investor in the business. Nevertheless, as an investor you share the company's fortunes -- good or bad.

Many African American households try to avoid investment risk by investing their money in "sure things" like bank certificates of deposits (CDs), fixed retirement accounts, and life insurance cash values. Unbeknownst to these investors, the money they deposit at these financial institutions is ultimately invested into the stock market. Most banks, pension plans, and insurance companies invest a large portion of their assets in the stock market. They do so to earn a 12 percent return. These shrewd financial organizations then credit the sure-thing savings account with 4 percent annual interest and keep the additional interest (8 percent) as profit.

Historically, the stock market has been one of the best investments to increase wealth and protect your income from inflation. Theodore J. Miller drives this point home in his book, Invest Your Way to Wealth. Regarding stock ownership, Mr. Miller writes that "If it's wealth you want, look to the stock market. No other investment available to intelligent amateurs with average resources, average willingness to take risks and limited time to spend on active management delivers as well as stocks over the long run. Not real estate. Not bonds. And certainly not savings accounts....Stocks aren't the only things that belong in your investment portfolio, but they are the most important."

You will be primarily using mutual funds, a proven method of wealth accumulation that people have been using for more than seventy-two years.

SELECTING A MUTUAL FUND

Before investing in a mutual fund, you must identify the goal you want a mutual fund to help you achieve. Do you want to have an emergency fund? Will the funds be used to pay for college or retirement? Will you need the fund to provide extra income now or can you wait several years before using the income the fund generates? When selecting a mutual fund, as with selecting a stock, you always want to match the fund objective with your investment goal.

For example, our primary goal is to build a net worth of 200,000 in ten years. Therefore, we selected mutual funds that offer the potential for capital appreciation. Our balanced fund, our growth and income fund, and our international equity fund fit this goal. We will be investing a small amount of money on a regular basis (dollar-cost averaging), and we will also try to find a no-load or low-load fund. Load is the word mutual funds use to refer to a sales charge. All mutual funds are in business to make money, and they do so in many ways. Some take out a sales charge when you invest; others take out a

sales charge when you redeem your shares. You can pay your fee before or after investing. If you want the fund, you will have to pay the sales charge.

In addition, mutual funds charge some form of annual management fee. As a rule I try to avoid stock funds with annual expense ratios greater than 1.5 percent. You should also avoid funds that have total expense ratios greater than 5 percent. You can find sales-charge information in the fund prospectus and its annual report.

REVIEW YOUR CREDIT REPORT

A good credit report is essential when you apply for a loan. On the other hand, a bad credit report can lead to denial of requested credit. It is up to you to maintain a good credit history as well as to monitor your credit report for errors.

The first time you applied for credit, your credit history started ticking. Each time you take out a loan, make a payment, or apply for new loans or credit, your report is updated.

Credit agencies are the bureaus that retrieve, handle, and disperse personal credit information. It seems as if credit bureaus know every thing about us. Personal finances are not the only pieces of information contained in credit reports. Past work history, employment history, and a reflection of personal lifestyle are included as well.

The function of credit agencies is to supply information to various businesses such as stores, lending institutions, and employers. The credit agency itself does not rate your credit; it only supplies the information, including past and current obligations, paid-in-full obligations, and negative or positive information. There are many credit bureaus and they do not necessarily contain the same information.

YOUR REPORT

Periodically, you should review your credit report. Many times there may be errors, deletions, or additions to your credit report that may cast an unfavorable view on your credit history. It is estimated that the credit reports of approximately 100 million Americans have incorrect information. Remember, your report can determine an acceptance or denial of credit you request.

If you find any errors or misstatements, it is up to you to initiate action to make a correction on your statement. Most credit bureaus have correction spaces on the credit report itself.

REMOVAL OF NEGATIVE COMMENTS

If you have an account that was handed over to a collection agency, you may have developed a repayment plan with the agency or creditor. Your repayment will not necessarily remove the negative comment on your credit report. The

following steps may assist in the removal of a negative entry:

- When you propose a payment plan to a creditor, ask for a letter promising the removal of the derogatory information on your credit file. Keep a copy of that letter.

- Make timely payments.

- Ask the creditor how long it will be before it contacts the credit agency to request the removal.

- Make sure to follow up with the credit bureau by requesting a copy of your credit report.

- If you find there is still a negative comment after a reasonable time period, contact the original creditor in writing and include a copy of the promissory note.

- If the creditor doesn't act, write to your state's Department of Consumer Affairs. Send any and all documentation to the department and send a copy of the letter back to your creditor.

- If you see negative or unfavorable remarks that you want to delete from your credit report, you must dispute the notation. If the above actions don't clear up your dispute, you may still file a statement that will be included as part of your current credit file. This statement should be one hundred words or less and as clear and concise as possible. Again, the statement cannot be a reason that explains the circumstances leading to the nonpayment or late payment.

If your dispute results in action by the credit agency (e.g., deletion, revision), the credit bureau must notify creditors, at your request, who received a copy of your credit report during the last six months.

FAIR CREDIT REPORTING ACT

The Fair Credit Reporting Act (FCRA) was passed by Congress to protect consumers against the circulation of inaccurate or obsolete information and to ensure that consumer reporting agencies adopt fair and equitable procedures for obtaining, maintaining, and giving out information about consumers. Under the FCRA you have the following rights:

- To be told the name and address of a consumer reporting agency that was used to deny you credit.

- To find out the nature, substance, and sources of the information that has been collected about you.

- To obtain, free of charge, a copy of your credit file if you have been denied credit within the last thirty days.

- To be told who has received a report within the last six months (or two years if used for employment purposes).

- To dispute inaccurate or incorrect information.

SMART TAX MOVES

Every American taxpayer must work forty-five days just to pay his or her annual federal tax bill. Imagine how much money we could save if we had to work only two weeks a year, as opposed to almost four weeks a year, to pay that annual bill.

There are three major ways to reduce your taxes. Let's take a closer look at each of these tax saving strategies.

DEFERRING EARNED INCOME

One of the best ways to reduce your current income tax bill is to defer a portion of your annual income. People do this by investing in an Individual Retirement Account (IRA), a 401(k) plan, a tax-sheltered annuity, or any other pension plan. With every dollar you invest in such plans, you are deferring a portion of your earnings to another time period on the assumption that when you need these funds you will be in a lower tax bracket or have an opportunity that will more than pay for your tax obligation.

Today, most taxpayers have the opportunity to put money into deferred savings or retirement plans, yet very few take advantage of these programs. Many people believe that they should not tie up their money for that long a period of time because they will not be able to touch the money without penalty until retirement. However, let me point out that in programs like your 401(k), a family can use the funds for certain emergencies, education, or a mortgage down payment. Even if you can't touch the money for some time, that does not mean that you should not place a portion of your earning into a tax-deferred program, especially, when many of these programs will allow you to dollar-cost average into an equity mutual fund.

Investments that offer tax-deferred compounding usually grow faster than non-tax-deferred investments.

You can also defer your interest income by placing your investments in vehicles that offer income-deferred accumulations. Here are some investments your family might chose to defer income:

- Treasury Bills. If your situation warrants short-term deferral of income, treasury bills may provide some help. Since treasury-bill interest is not taxed until the rated security matures, you would be able to defer the recognition of this interest by one tax year.

- Savings Bonds. A longer-term benefit can be derived from the purchase of Series EE savings bonds. The investor can choose to recognize the income of these bonds, which are bought at a discount, when the bonds are cashed in. As the holding period required to receive the minimum guaranteed interest is longer term, the income is deferred for a longer period if the bond is held to maturity. All savings bonds must be held five years before they can be cashed

in. Most bonds mature in thirty to forty years.

- Life Insurance Policies. Whole-life, variable-life, and universal life policies generally provide a tax-free accumulation of investment funds over long time periods. Life insurance policies are not appropriate for short-term investing because of the substantial up-front sales costs and surrender charges.

- Annuities. Annuities are a cousin of life insurance policies. In a typical annuity contract, the insurer agrees to make payments to you as long as you or your designated beneficiary lives, sometimes for a fixed minimum number of years.

- Both life insurance and annuities are complicated arrangements involving many provisions and factors. Before you make a withdrawal or take out a loan in relation to either, you should discuss the effects of these actions with your insurance and tax advisers.

INCOME SHIFTING

Beginning in 1993, family members may pay substantially different tax rates -- from a low of 0 percent to a high of 39.6 percent. Differences in tax brackets may encourage shifting income and assets from high-bracket individuals to low-bracket individuals, who may include your children and grandchildren, as well as your parents. Here are several ways to shift income:

- Use a Uniform Gifts (or Transfers) to Minors account to shift income to children or grandchildren.

- If possible and applicable, pay children a wage for services actually rendered to gain business.

- Give outright lifetime gifts to charity of appreciated property to create an income tax deduction and get income (from the property) out of your return.

- Give gifts to children or other family members. There is a 10,000 per donee exclusion (20,000 if a joint gift is made) from the Uniform Gift/Estate taxes.

- Just a reminder. If you have a favorite church, black college or university, or nonprofit organization, you can also make it the beneficiary of one of your life insurance policies. Your payments will be tax deductible, and the organization will benefit from the face value of the policy.

OTHER TAX-SAVING MEASURES

- Purchase municipal securities (notes, bonds, money markets or funds) to avoid income taxes on interest.

- Time sales of investment property to utilize capital losses up to the annual 3,000 limit.

- "Lump" property tax payment by paying two winter payments in one taxable year. Pay estimated state income or intangible taxes before year end. Also, always keep in mind that the tax deductibility of mortgage payments makes home ownership a great tax move as well as a smart money move.

- Make a year-end property contribution of clothes, used furniture, etc. Remember IRS documentation rules. If the value is over 175, get a receipt and attach it to your return. If the value is over 500, an additional form is required. If the value of the property is over 3,000, an appraisal is required. Because many African Americans make their greatest contribution to African American churches, remember to claim these contributions on your tax form. Tax deductibility will not make your tithe any less devout.

- Contribute appreciated property to maximize the deduction and avoid capital gains. Certain income limits apply. This tax-saving measure also works for personal property that you no longer want. For example, donate your old car to a nonprofit organization and deduct the contribution on your income tax.

INCREASE YOUR NET WORTH

Many people are skeptical about tax planning. They wonder if it really is beneficial and if they will incur the wrath of the IRS if they plan. It is beneficial to try to save money on your annual tax bill, especially if you plan to invest the tax savings in the American free enterprise system. As eager as our government is to have you pay your tax bill, it is also eager for you to invest in long-term investments that ultimately help create more employment opportunities and businesses.

Most African American families can effectively reduce the federal tax bill by purchasing a home, and investing in an individual retirement account (IRA) and/or (401k) plan at work.

You could make an adjustment on your W-4 (withholding) tax form and have most of this monthly savings come directly to you. In doing so, the family can begin a monthly investment program. I advise this strategy only for clients who are committed to investing their savings. Otherwise, the family might have additional taxes to pay at the end of the year and not accumulate any investment capital.

Justice Oliver Wendell Holmes once wrote, "Every American only has to he responsible to pay their fair share of taxes." There is nothing wrong or illegal in trying to reduce your tax liability as long as you do it legally and effectively.

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GRAPHIC: Chart, Assets and Liabilities of Whites and Blacks

JOURNAL-CODE: EG
LOAD-DATE: August 17, 2001

Evidentiary Exhibit Number 170

Chicago Tribune

March 10, 1996 Sunday, CHICAGOLAND FINAL EDITION

SECTION: REAL ESTATE; Pg. 1; ZONE: C

LENGTH: 1745 words

HEADLINE: A HUGE LEASE ON LIFE;

SUPER LUXURY RENTALS SHOW TRANSIENT RESIDENTS DON'T JUST LIVE MONTH-TO-MONTH

BYLINE: By Jane Adler. Special to the Tribune.

BODY:

The image of renters is of a band of nomads moving from apartment to apartment, living month-to-month, hoping to someday scrape together enough money to put a small down payment on a starter home.

Rental properties, too, are often unflatteringly stereotyed. That big three-syllable word, "apartment," somehow sounds small, bringing to mind a second-floor walk-up that's less than shipshape because the landlord doesn't care. And the cookie-cutter layout and decorative finish meant to please everyone doesn't dazzle anyone.

Renting is housing on the cheap. At least, that's the impression.

But tucked into the Sunday newspaper ads, between the suburban ranches and high-rise co-ops for sale, are a handful of upscale apartments and single-family homes for rent that elevate leasing to a whole new level.

There are condominiums with as much square footage, and certainly more spectacular views, than most country estates. There are quaint brownstones and modern homes in Lincoln Park. And although most high-end rental properties are in the city, there are some suburban mansions and houses for lease, too.

The heavenly places are matched by sky-high prices.

Agents who specialize in luxury rentals say the monthly cost can be $4,000 to $13,000. That translates into as much as $156,000 a year--a lot more than most people's annual income.

"What really gripes me is when people say 'He's a renter' like it's a putdown," said Barbara Stewart, who leases expensive apartments and houses for Rubloff Inc. in Chicago. "I have rented to people who own homes all over the world, and they could buy and sell a lot of these people who put them down."

Robert De Niro, for instance. When the actor was here recently shooting a movie and in need of temporary lodging, Stewart showed him a luxury condominium. De Niro, she said, flew in from out of town 12 times to tour the apartment during all parts of the day, from dawn 'til dusk, just to see whether he'd like living there. (He finally decided to bunk at a hotel, but rewarded Stewart's efforts with flowers and champagne.)

Stewart has found spots, though, for Meg Ryan and Elliot Gould. And she talks in an unassuming way about the time Kevin (Costner, that is) was in town.

The occasional movie star who rents for a few months does not, however, a real estate market make.

Whereas hundreds of expensive condominiums and single-family homes may be for sale in the suburbs and city at any given time, there are only about 80 luxury places for rent, those working in the market estimate. Most of those in the city are clustered in buildings like Water Tower Place, Olympia Centre, Chicago Place and 134 E. Delaware St. (above Bloomingdale's). In sum, the upscale rental market isn't big.

Generally, well-heeled renters don't access the market through the traditional methods of apartment search firms or relocation companies. Instead, they turn to the few residential brokerage firms with high-end rental property agents, a group that can be counted on one hand.

Laura Rubin handles upper-bracket rentals for Kahn Realty, Chicago, and she sees a growing need for lavish places to lease. "There are more people looking for high-end (rental) properties," she said.

Usually, renters of upscale properties are in transition or trying a new way of life. And, not much different than those who'd prefer an extended engagement before marriage, renters with money don't want to commit too fast.

The Llobell family, who relocated here from a 4,500-square-foot home on two acres in Michigan when husband Mark's job changed, is typical of rich renters. They wanted to try living in the city and leased a rather pricey townhouse in Lincoln Park.

"My wife and kids love it," said Llobell, referring to his experiment with urban life. And because they've now grown accustomed to traffic noise and sirens in the night, instead of deer quietly stirring outside their country home, Llobell thinks he'll probably stay in the city for at least the next five years. He has an option to buy his rental townhouse and doesn't see himself moving to the suburbs anytime soon.

Housing experts say transferred executives, who make up the largest portion of high-end renters, don't want to make a mistake and buy an expensive house before they have a chance to learn more about their new communities and their new jobs.

"Employees aren't willing to take the whole plunge," said Cris Collie, executive vice president of the Employee Relocation Council, a trade group of relocation professionals based in Washington. "They want to see how the job shakes out before they make a firm commitment. There's some trepidation to put down firm roots."

Mark J. Grant, an investment banker who recently moved here for his job, would like to put down roots, but he already owns an expensive house in Florida. So he's not looking to buy just yet. Besides, he's nervous about talk of a flat tax, which he believes could hurt housing values. But, he said, "I still wanted a nice place to live."

Agents say someone accustomed to fine quarters usually won't settle for a two-bedroom $200,000 apartment, just because he or she needs something fast. Instead, these people want a place that matches their previous lifestyles, even if they're not ready to buy.

Grant, who's not married, found a four-story single-family home in Lincoln Park with 5,500 square feet of living space. The house had been for sale when the owner, who had been transferred to New York himself, decided that it might be easier to rent the pricey place.

Apparently, that's true.

Agents bemoan the lack of suitable high-end properties for rent, which usually makes leasing one a quick deal.

Rubin of Kahn Realty has a client looking for a three-bedroom apartment in a high-rise with a doorman and parking. "This woman will spend $4,500 a month and there's not one thing (like that) on the market right now," she said.

Upper-end rentals have been pared, in part, by the recent wave of condo conversions. Low interest rates also have encouraged owners to keep expensive homes on the market for sale, instead of putting them up for rent.

Other factors have kept a clamp on the supply of luxury flats.

Possibly fearing an onslaught of wealthy transients, many co-op buildings ban renters outright. And condominiums always have the option of placing restrictions on rentals.

In the suburbs, where few true luxury rental buildings exist, there aren't many listings of big fancy houses for lease either.

"High-end rentals are really piecemeal here," said April Pozulp, sales agent at Prudential Preferred Properties in Hinsdale. "But when one is available, it's easy to rent."

That means property owners sometimes have their pick of renters.

Colleen and Paul Tyler of Burr Ridge have rented their 4,000-square-foot house because Paul's job requires a two-year stay in London. After their stint in Europe, they want to return to the same house.

Colleen Tyler says their house was rented by a man who had no place to live because he had sold his old house and the new one he's building isn't ready. He was the second person who walked through. "We've never done this before, but it was easy," she said.

The Tylers, like many high-end suburban property owners, listed their house with a regular sales agent. Since there are so few luxury suburban rentals on the market, agents usually take them more as a courtesy to the owner than anything else.

Agents also say favors can generate a sale several years later. According to Judy Oberman of real estate company Kahn-Manierre in Winnetka, owners who rent their expensive homes often decide to sell upon their return from a temporary job reassignment. They anticipate a seamless re-entry here, but find their needs and tastes have changed in the interim, she says.

If absent property owners do decide to keep a lavish home, it's hardly ever as an investment. Fat rental incomes, for the most part, don't even cover expenses.

Bill Riblet owns a six-bedroom, 4 1/2-bath home in Kenilworth that he has been renting since 1980 for about $5,000 a month. He's had foreign bankers and

consulates rent his house, and now a major leaguer is interested in the property.

Riblet is keeping the house so he can sell it to his daughter, but financially, he says, it's a wash: "It doesn't work out to rent. The taxes are too high, and the rent doesn't cover expenses."

For renters, the process of leasing a $10,000-a-month house is only slightly more formidable than renting a convertible studio. Most leases are annual.

Agent Stewart says some upscale property owners will demand three months' rent upfront. And although she's seen few problems with well-heeled renters in her 16 years of leasing, big damage deposits are customary.

"If the owner goes in and finds damage, then they have nothing. Now we are asking for heftier security deposits," said Stewart, explaining that while she painstakingly reviews all the points in the lease, she doesn't manage the property.

Careful background checks of renters, even of well-known actors and sports figures, are common too. "No owner signs a lease before he sees a credit report. I insist on it," said Stewart.

Meanwhile, Stewart is trying to convince developers to build a luxury rental building in the city because she thinks more choices are needed for those who prefer more opulence and less permanence. "Chicago is a livable city for renters at all levels," she said.

RENTING ON THE HIGH SIDE

- Who leases?

Incoming transferees, expatriates, movie stars, those in second homes, families wishing to "try out" a neighborhood before committing to purchasing.

- What do they like?

City high-rises, Lincoln Park brownstones, suburban mansions and large single-family homes.

- How much do they pay?

Anywhere from $4,000 to $13,000 per month.

- What's available?

Not much. Despite strong demand, only about 80 luxury rental properties are on the market in Chicago at any one time.

GRAPHIC: PHOTOS 3PHOTOS (color): Mark Grant (above), an investment banker, rents a home on Chicago's North Side where he doesn't have to worry about restrictions on pets, something that drives many out of the traditional rental market. Babara Stewart (left), a broker with Rubloff, is one of the few real estate professionals who specialize in high-end rental property. Experts say demand is great for such residences, but supply is limited. Tribune photos by Ovie Carter.; PHOTO: In north suburban Kenilworth, a large house like this one can rent for $5,000 per month or more. Movie stars are among the clients looking for short-term leases on such homes. Tribune photo by Walter Kale.

LOAD-DATE: March 10, 1996

Evidentiary Exhibit Number 171

St. Louis Post-Dispatch (Missouri)

March 10, 1996, Sunday, FIVE STAR LIFT Edition

SECTION: WAR PAGE; Pg. 1B

LENGTH: 2785 words

HEADLINE: THE HOUSE THAT DICK BUILT

BYLINE: Tim Poor Post-Dispatch Washington Bureau

DATELINE: COROLLA, N.C.

BODY:

THE BEACH IS EMPTY now in this resort community, with only the occasional shriek of a gull and the sound of Atlantic Ocean waves breaking the chilly quiet of North Carolina's Outer Banks.

In this offseason, the area has seen visitors of another sort: R epublican investigators looking for wrongdoing by House Minority Leader Richard Gephardt in connection with a 1991 land deal in which he participated.

On Feb. 2, Rep. Jennifer Dunn, R-Wash., filed a complaint with the House ethics committee, alleging that Gephardt had misreported the transactions on financial disclosure reports, loan documents and/or tax returns. Gephardt, D-St. Louis County, has denied any impropriety.

A Post-Dispatch investigation found possible merit in only one of the allegations: Gephardt failed to list his sale and acquisition of property on the congressional disclosure report he filed in 1992.

Gephardt told the committee about the exchange in a letter to the committee 19 days after he filed the report. The bottom line: Nineteen days in which the property transaction was not disclosed to Congress. And the ethics rules are unclear as to whether he was required to disclose it at all.

"The allegation seems fairly trivial," said Ronald M. Levin, a Washington University law professor and Congressional ethics expert who reviewed the disclosure question at the request of the Post-Dispatch.

"The dispute seems to be one on which reasonable people can disagree. But even if Gephardt made the wrong judgment, it was a reasonable one," he said. "The whole matter seems to be one that doesn't deserve attention from the ethics committee and indicates the way the process has been abused by members of both parties."

He compared the charge with one that Democrats lodged against House Speaker Newt Gingrich, R-Ga., alleging that he violated House rules when he mentioned the toll-free telephone number of a fund-raising group he was associated with on the House floor. The ethics committee recommended no action be taken against him.

The committee is expected to consider the complaint against Gephardt soon, although a meeting has yet to be scheduled. If the Gingrich complaints are any indication, it could be months before it is resolved, throwing a cloud, however wispy, over Gephardt's personal finances.

Indeed, Democrats believe the ethics complaints against Gingrich prompted the attack on Gephardt.

"It's retribution time," one Gephardt aide remarked grimly.

Gephardt won't answer questions about the complaint, although aides and one of his lawyers have spent several hours answering reporters' questions and provided extensive documentation about the land transactions.

In a statement, Gephardt called the complaint "totally groundless" and said he has obeyed "every law and code that is required of me."

"This whole matter says a lot about the partisanship of this Republican Congress, where political attacks matter more than the facts," he said.

GOP Targets Gephardt

Dunn, a second-term conservative who represents a suburban district outside Seattle, won't answer questions about her complaint either. A staff aide said her actions weren't political and that she didn't discuss them with leadership. "Anybody who knows Jennifer knows she does substantive things, not partisan attacks," said the aide, Phil Bond.

But there's no doubt Republicans are seeking to use the allegations against Gephardt, whom they have targeted for defeat in November. The Republican Congressional Campaign Committee recently sent out a news release accusing Gephardt of "ethical and financial transgressions" and saying the Justice Department "will likely file charges against Gephardt."

The Justice Department denied that it had even opened an investigation, much less readied charges. "We're unaware of a basis for such speculation," said Bert Brandenburg, a Justice Department spokesman,

The political implications of the complaint go further than whether Gephardt technically complied with complex tax regulations or disclosure requirements. His part-ownership of a luxury beachfront investment property has occurred at the same time he has traveled the country excoriating Republicans for advocating "tax breaks for the rich," such as the abolition of the capital-gains tax for which he took deferments.

So it is with some glee that Gephardt's political opponents are pointing out that he owns a big house on the beach, with commentators like Rush Limbaugh, Gordon Liddy and the Wall Street Journal editorial page calling attention to what the Journal called a "$ 900,000 mansion."

Actually, the property is worth $ 730,000 to $ 760,000, according to July 1995 appraisals of the property, of which Gephardt and his wife, Jane, own half. They are selling that half to their partners, a Bethesda, Md., couple. And while Gephardt is hardly poor, neither is he among the wealthiest members of Congress. The Corolla property was the only asset listed on his 1994 financial disclosure form, making his assets among the least on reports of any member of Congress from Missouri.

Deferring The Taxes

The Outer Banks is a series of long, skinny barrier islands off the coast of North Carolina that have seen a rapid rise in tourist popularity over the last two decades. Builders have been erecting more and more large, wooden frame houses with names like "Sweet Spot" and "Summer Getaway." Most of the owners rent the houses to tourists, many of whom make the five-hour drive from the Washington area.

Renters range from the well-to-do to the moderately affluent who get together groups of friends and families to share the expense of a long weekend or a week on the beach.

Gephardt is one of many who have profited from the building boom here.

In 1984, he paid $ 115,000 for a vacation house he owned in the resort village of Duck, which he rented out for several years. He didn't rent the house in 1991, but sold it in March of that year for $ 183,000. He put his profit into the purchase of an oceanfront lot in the Corolla Light subdivision several miles up the beach. He paid $ 375,000 for the lot. The sale was financed initially by the developer, Outer Banks Ventures.

The Gephardts were able to defer paying capital gains taxes on their profit from the Duck sale by classifying the two transactions as an exchange of similar, investment properties under the U.S. tax code.

Gephardt filed his financial disclosure statement for 1991 on May 15, 1992, but did not include the Duck home as an asset. Neither did he report his sale of the home and his acquisition of the Corolla lot and the new home.

Some sharp-eyed ethics-committee aide noticed that for the first time in years, the Duck property hadn't been mentioned on Gephardt's annual report, and asked about it. In a June 3, 1992 letter to the committee, Gephardt said he hadn't disclosed the sale "because it was my understanding that the sale of a personal residence, including a secondary residence or vacation home, did not need to be disclosed if the residence was not used for rental purposes. While in prior years I have rented my vacation home and, therefore, disclosed it on my report, in 1991 the home was not rented and we received no income from it."

"For the record, however, the home was exchanged for a new vacation home in April 1991." He said the amount of the transaction was $ 100, 000-$ 250, 000, and that he realized a gain of $ 50,000-$ 100,000.

Because Gephardt disclosed the land exchange in his letter to the ethics committee just 19 days after he filed the report, those details he revealed were publicly available - and reported by the Post-Dispatch - in June 1992. The letter did not report the value of the Corolla property he had acquired; it wasn't reported until a year later.

Ethics laws and the guidelines are unclear on the matter.

The law says sales or exchanges must be reported of "real property, other than property used solely as a personal residence of the reporting individual or his spouse." It requires the reporting of "any interest in property held during the preceding calendar year . . . for investment or the production of income."

The instruction booklet provided to members says: "A second home, vacation house, or other property that is held purely for recreational purposes and is not rented at any time during the reporting period need not be reported."

Early in 1992, Gephardt entered into a partnership with Jeffrey B. and Michele A. Conley, who bought half the lot in Corolla. The partnership took out a $ 493,000 loan that was used to pay off the loan from the developer and to finance construction of a six-bedroom house, which they called "Northern Star."

The deed of trust that Gephardt and the Conleys signed for the note from the bank includes a provision initialed by the couples that states that the borrower "shall only use the property as borrower's second home."

Designating the property as a second home was beneficial to both the bank and the partners. It meant the bank could look to the personal assets of the Gephardts and Conleys to repay the loan, rather than having to rely on rental income. The partners had to put less money down and got a better interest rate as a result.

Nothing in the loan documentation prohibits rental of a "secondary home," and renting such homes is not unusual, according to those in the field.

"I don't see anything improper about it," said McNeill Chestnut, a North Carolina assistant attorney general who advises the state banking commission and who reviewed the deed of trust at the request of the Post-Dispatch. He said the secondary home designation was inserted to differentiate it from Gephardt's principal home.

"It's not unusual for a bank to finance a piece of investment property like that," he said. "You see it all the time."

A review of other, similar deeds of trust for Outer Banks homes that are currently being rented showed that the owners had signed a "second-home rider" with language similar to that Gephardt initialed.

When Gephardt sold half of the Corolla lot, he lost half the tax deferment on his gain from the sale of the Duck property, and paid those taxes in 1993.

The three-story, six-bedroom home was completed in 1992 and the partners began renting it out the following year. It now commands as much as $ 5, 000 a week during the peak summer season.

Fund-raising Events

In 1991, the year Gephardt exchanged the Duck property for the Corolla lot, his political action committee - the Effective Government Committee - began holding fund-raising events on the Outer Banks.

Campaign finance reports show the fund-raising events did raise money, though the contributions amounted to little, if any, more than it cost to put on the events. When Gephardt was questioned in 1994 by the Post-Dispatch about the large operating expenses of his PAC, he said that part of the reason for the beach events and other, similar getaways was to continue to build relationships with longtime fund-raisers and donors.

"What you can't do is herd people into a hotel room," he said.

The developer from whom Gephardt purchased the Corolla lot, Outer Banks Ventures, is operated by Richard Brindley, a longtime developer in the area. His son, Douglas Brindley, is an officer of the company and runs B&B on the Beach, a lodging and catering company with which Gephardt's PAC has done about $ 57,000 worth of business in the last three years.

Records show Gephardt's PAC didn't do any business with B&B until 1993, two years after he bought the lot. The committee paid about $ 125,000 in fund-raising expenses to businesses on the Outer Banks since 1991; Douglas Brindley said B&B was the only one in which he or his father have a financial interest.

Suggestions of impropriety in Gephardt's dealings with the Brindleys are out of line, Douglas Brindley said. "There really isn't any smoking gun here," he said. "Nothing occurred that was abnormal."

"If someone's questioning his ethics, it's political mumbo jumbo. It's a shame they're giving him a hard time on a vacation home he's probably too busy to enjoy."

Records show that the Gephardts have spent little time at the home since it was built. And a list of its renters shows none that contributed to his campaign.

Gephardt's leadership PAC was most active in 1994, an election year that Gephardt hoped would end with the Democrats retaining control of the House and his ascension to speaker. That summer, acting on tips, several news organizations looked into Gephardt's property in North Carolina and his PAC's spending there. None published stories about Gephardt's house.

In November, Republicans gained control of the House and Gephardt was relegated to leading the Democratic minority. One of his aides in the party leadership, Rep. David Bonior, D-Mich., began going after Gingrich last year, filing numerous complaints against him with the ethics committee.

One of the newspapers that had looked into Gephardt's property in the summer of 1994 was the Washington Times, a conservative daily newspaper. In August 1995 - a year later - its magazine, Insight, published a story:

"How Dick Gephardt Got His $ 700,000 Mansion in the Sky," saying that Gephardt had been inconsistent in characterizing the property to the bank, the IRS, and to Congress.

Gephardt's "mansion" quickly became fodder for conservative talk show hosts like Limbaugh and Liddy. The Post-Dispatch looked into the land deal, but, like most other news organizations, found nothing to justify a news story.

Last summer, Gephardt's aides say, he had the Corolla property appraised and began talks with the Conleys about buying him out. Aides say he wanted to sell to finance his children's college tuition.

Then, on Feb. 2, Dunn filed her complaint, citing the Insight magazine piece. The complaint sparked a new round of anti-Gephardt fervor on the part of Republicans, particularly by the Republican Congressional campaign committee. On March 1, Rep. Bob Barr, a freshman Republican from Georgia, asked the Justice Department to initiate a criminal investigation of Gephardt for possible false statements to the IRS or to his bank on loan documents.

Meanwhile Gephardt began to finalize his sale of the house, signing over the property to the Conleys last month, although aides said the transaction was not yet complete.

They said the sale had nothing to do with Dunn's complaint.

LAND DEAL CHRONOLOGY 1984 - Gephardt buys house in Duck, N.C. for $ 115, 000. Over the next seven years, he rents out the home, getting $ 5,000 to $ 50, 000 per year.

1991 - Gephardt doesn't rent the home, but puts it up for sale, eventually getting $ 183,000 for it. At about the same time, he buys a lot in Corolla, N.C., for $ 375,000. For a down payment, he uses the $ 68,000 he made on the Duck property, taking out a loan from the developer for the balance. The transactions are made through third-party lawyers to qualify for a tax deferment.

1992 - On his income-tax return for the previous year, Gephardt lists the property deal as a "Starker exchange" of similar, investment properties, thereby deferring capital gains taxes on his profit from the sale of the Duck home.

On May 15, he files his personal financial statement for 1991, required by law to be submitted annually to Congress. He does not list his North Carolina property holdings, transactions or loan. On June 3, in response to an inquiry from the House ethics committee, Gephardt discloses the land deal and said he thought he didn't have to report it because that year, it was a "second home" from which he got no rental income.

On March 4, Gephardt sells half his interest in the Corolla lot to Jeffrey B. and Michele A. Conley, a Bethesda, Md., couple brought together with the Gephardts by a real estate agent. The Gephardts and the Conleys enter into a partnership to build a house on the lot, and take out a $ 493,000 bank loan to pay off the developer and build the house. They sign a separate, $ 30,000 note to the developer.

Construction is completed and the partnership begins renting the house in 1993, which now commands $ 5,000 per week in peak summer season.

1993 - Gephardt lists his half-ownership of the Corolla property on his disclosure report to Congress for the previous year. On his taxes, he pays half the deferred capital gains tax on his profit from the sale of the Duck home.

1995-96 - In 1995, aides say, Gephardt decides to sell the home to raise money for his children's college tuition. In July, the property is appraised at $ 730,000-$ 760,000. In February 1996, the transaction is begun, but is not completed.

GRAPHIC: PHOTO, MAP; (1) Color Photo by Tim Poor/Post-Dispatch - This six-bedroom ocean-front house in Corolla, N.C., is partly owned by Rep. Richard A. Gephardt. (2) Color Photo by AP - ABOVE: U.S. House Minority Leader Richard A. Gephardt, D-St. Louis County, first bought vacation property in North Carolina in 1984. (3) Color Photo by Tim Poor/Post-Dispatch - BELOW: The Atlantic Ocean and uncrowded beaches, seen from the deck of Gephardt's property in North Carolina, are powerful tourist draws to the Outer Banks. (4) Photo - Rep. Richard A. Gephardt, D-Mo. (5) Map by N.Y. Times News Service - Outer Banks - map of East Coast and area of detail.

LOAD-DATE: March 11, 1996

Evidentiary Exhibit Number 172

The Miami Herald
Found on Miami.com

The Miami Herald
February 11, 1996 Sunday BRWRD EDITION
SECTION: HOME & DESIGN; Pg. 27H
LENGTH: 446 words

HEADLINE: RENT OR SELL CONDO WHEN YOU LEAVE STATE?
BYLINE: JULIE GARTON-GOOD Herald Columnist
BODY:

Q What are the factors I should consider in deciding whether to rent or sell my condo when I move out of state?

I could make about $150 per month, after mortgage and maintenance payments, if I rent, or about $20,000 after paying off the mortgage, if I sell. How do these factors enter into my decision?

M.J., Miami

A The most obvious factor is financial. Would the extra cash help you out?

Would you feel comfortable putting the $20,000 in investments that could considerably increase your yield? Would it make sense to hold the condo as an investment and depreciate it? These questions can best be answered by visiting with your tax adviser before taking any action.

Do the figures you gave reflect costs? You could have closing and sale costs deducted from the $20,000 and rising maintenance costs deducted from the $150 monthly rental income.

One question many potential landlords fail to ask if whether they are mentally prepared to handle real estate long distance. Problems such as late rent checks and tenants who skip out are magnified when you are hundreds of miles away.

Should you decide to sell, timing can be important. If properties of similar size and design in your area have been slow to move, perhaps it would make sense to wait until the market is stronger. Q. I am getting divorced and will have enough equity from my portion of the sale of our home to purchase a house for myself.

One has just come on the market that is ideal, but I doubt that it still will be available by the time the divorce is final.

Do you think I should purchase it and not tell my soon-to- be ex, or perhaps have a friend purchase it for me and buy it back later?

D.S., Miami Beach

A. Consult the attorney who is handling your divorce before you make any real estate purchase. Because the divorce is not final, any real estate you purchase could become an asset of the marriage, thus potentially jeopardizing the settlement.

As far as having someone else purchase the house for you, consider what it would cost. You could have duplicate fees for attorney costs, deeds, title insurance and other costs, since you will have to transfer title later. And if you're dealing with a new loan, the mortgage might not be transferable to you.

Even though you love this house, your attorney may advise that the risk you take in purchasing it may not be worth it until the ink is dry on the divorce papers.

Julie Garton-Good is a licensed Realtor and a real estate educator, lecturer and writer. If you have questions about real estate, write: Julie Garton-Good, Home Section, Fifth floor, The Herald, 1 Herald Plaza, Miami, Fla. 33132.

LOAD-DATE: October 25, 2002

Evidentiary Exhibit Number 173

The New York Times

November 19, 1995, Sunday, Late Edition - Final

SECTION: Section 9; Page 1; Column 2; Real Estate Desk

LENGTH: 1764 words

HEADLINE: In Co-ops, Renting Is a Growing Concern

BYLINE: By NICK RAVO

BODY:

LORETTA KRIARIS thought she was doing her fellow co-op owners a favor two years ago by capping -- at eight -- the number of apartments that could be rented at any given time in her 115-unit building in the Briarwood section of Queens.

After all, a high percentage of rentals had made it difficult for her co-op to refinance its mortgage, for apartment owners to sell their units and for prospective buyers to get loans.

"It was highly restrictive," said Ms. Kriaris, who was board president at the time. "But it was in the context of seeking refinancing. It was a last-ditch effort to stave off default and get rid of an exorbitant rate of interest that the co-op was paying on the underlying mortgage."

There was also, Ms. Kriaris said, the matter of the building's ambiance with many of the apartments occupied by renters. "They have a different feeling and attitude toward the building than the owner-occupants do," she said.

Surprisingly, perhaps, the eight-unit cap was not appreciated by the majority of shareholders in the building, which is at 143-50 Hoover Avenue. About 57 percent of the apartments are rented out. And three months ago, a new board was elected that eliminated the cap.

"It is troubling," Ms. Kriaris said. "If there is no scrutiny and no control, ultimately this will have a deleterious effect on the building, and the number of rentals will escalate."

The conflict inside co-ops between unit owners who rent out their apartments and those who live in them is one of the most vexing issues in the co-op world today. Many boards in recent years have loosened sublease policies to extend relief to apartment owners facing financial hardship. At the same time, though, some boards have tightened the rules for a variety of financial and lifestyle reasons.

"I consider this to be the next big emerging co-op problem," said Marc J. Luxemburg, president of the Council of New York Cooperatives.

He estimated that from 1,000 to 2,000 buildings have some sort of serious conflict between renters and owners. There are 8,080 co-op buildings in the city, half of them in Manhattan, containing about 416,000 apartments. About 15 percent of the city lives in co-op units -- but almost half of them are renters.

There are also 1,040 condominium complexes, which sometimes have similar conflicts between renters and owners. Such conflicts arise less frequently in condominiums, however, because buyers often opt for condos because of the freedom to rent the units out with few restrictions.

Still, resident owners of condos can get just as annoyed as co-op owners if renters dominate a building, as is the case at Park Avenue Court, a 223-unit condominium in the old Gimbels store at 120 East 87th Street on the

East Side of Manhattan. There a consortium of Hong Kong investors bought 118 units and is renting them out; the developer had filed for bankruptcy.

"The building is not being maintained to the standard that it would if it were owner-occupied," said Joanna Townshend-Boegner, an apartment owner.

Such problems are much more prevalent and contentious at co-ops, however. And the problems are not limited to New York City. Many co-ops exist in the New Jersey suburbs and in Westchester County.

"The subletting issue is indeed one of the most difficult that co-op boards now face," said Mary Ann Rothman, executive director of the Council of New York Cooperatives.

Subleasing -- the technical term for renting a co-op unit, because the owners are the actual tenants -- isn't always a panacea for apartment owners who can't sell their units and must move or sell. Some co-op boards have refused to allow sublets. Others have tacked on fees. And even with the strong rental market, sometimes the rent doesn't cover the apartment owner's combined maintenance and share loan payment. Moreover, many co-op and condo owners are unaccustomed to acting as landlord, especially when it comes to dealing with tenants.

Subletting, however, can be even more of a headache for the co-op.

First, banks generally do not make "share" or "end" loans for individual units -- the equivalent of the mortgages used by owners to buy private houses -- if a building has more than 50 or 60 percent of its units occupied by subtenants. In a market where buyers are still often hard to come by, that can be a deal-killer for tenants who are trying to sell their apartments.

Second, a high percentage of subtenants may also endanger a co-op's ability to refinance its underlying mortgage -- the loan taken out by the co-op corporation to buy the building from the sponsor or the converter.

Third, renters, generally, have a reputation, perhaps ill-deserved, for lacking as much pride or concern for a building's appearance and operation as owners do. Worldwide Plaza, a condominium at 350 West 50th Street in Manhattan, last year tightened up its screening of rental tenants and its house rules after some tenants were spotted roller-blading in the hallways.

Fourth, in buildings where the sponsor has defaulted and subtenants still live in unsold units, such apartments revert back to the co-op. This, however, frequently creates a financial crunch because the board usually collects rents on these apartments that do not match what shareholders pay in maintenance; this is because the subtenants are generally living in rent-stabilized units that rent for significantly less than they would bring on the open market.

IF such apartments are vacated and the co-op corporation decides not to sell them, market-rate rents can be charged, as is the case with investor-owned units, and such rents can be equal to or even more than the maintenance that would be charged if the unit were a co-op.

But the far more common situation, according to Ms. Rothman and others familiar with co-op issues, is for rentals to fall short of expenses. This shortfall in revenue from subtenants, Ms. Rothman says, often causes the co-op board to raise the maintenance on all owners of apartments in the building.

"You have the shareholders subsidizing the renters," said Stuart Saft, a lawyer who serves as chairman of the Council of New York Cooperatives.

He added that co-op boards cannot even cut services because of the discrepancy between the amount of revenue collected from renters and the monthly maintenance paid by shareholders.

"If they do, the renters can then seek rent reductions," he said.

The wave of sponsor co-op defaults in the early 90's exacerbated this problem, as unsold units were often sold to investors who, rather than sell them, continued to rent them because of the strong market for rentals and the soft, albeit improving, market for co-ops.

Mr. Saft noted that the owners of co-op units, because of an exemption in the state's rent-regulation laws, can collect market rents for those apartments once the original rent-stabilized tenants vacate.

This exemption, he said, has created a disincentive for the owners to sell their units.

"During the downturn the last few years, no one was pressuring anyone to sell," he said. "But now the market has gotten better and the wave of sponsor defaults are mostly past. And still some owners aren't selling their units because of the rents they can get."

Mr. Luxemburg questioned whether the intent of the framers of the rent-regulation laws had been to allow an exemption from controls after an apartment is vacated in order to allow an investor or a sponsor to utilize co-ops as a permanent source of market-rent income.

He also said that continuing to rent these units rather than making a good-faith effort to sell them was inconsistent with the sponsor's obligation to the co-op and existing tenant-shareholders, even though sponsors are usually obligated to sell only a minimum of 15 percent of their units to make the co-op conversion legal.

"The sponsor put out an offering plan to convert the building to co-op status, but did that mean 100 percent co-op status or something less?" Mr. Luxemburg asked. "I would think an ordinary person reading an offering plan would think that the entire building would be converted.

"I find it surprising that the offering plans or regulations don't say that in so many words," Mr. Luxemburg said. "The problem is that it should be explicit but it is not."

Mr. Saft added that the growing role of co-op boards and unit owners as reluctant landlords could make them lobby for changes in the state's rent-regulation laws, which come up for renewal in the spring of 1997.

"Co-ops have never been involved in this issue before," he said. "It was always landlord-tenant groups going at it.

"But now there are a half-million co-op and condo owners who have an interest in seeing the regulations eliminated or curtailed," he said. "I think you will have an incredible fight in a year and a half, and I think you will see a fundamental change in rent control laws because of this."

MR. SAFT speculated that vacancy decontrol might be expanded beyond the current exemption. (Gov. George E. Pataki's Transition Committee on Housing and Community Development last year recommended phasing out rent regulations completely through vacancy decontrol -- the lifting of controls on all apartments as they become vacant. Currently apartments renting for more than $2,000 a month are, under the 1993 law, decontrolled when they become vacant.)

This may not have a direct impact on co-ops since they are already decontrolled upon vacancy, but it may remove an incentive some sponsors have for turning rental buildings into co-ops. "One of the reasons some sponsors converted to co-ops was to get vacancy decontrol," said Arthur Weinstein, a Manhattan lawyer who

specializes in real estate issues. "If vacancy decontrol applies to all rental apartments, then there is no reason to convert, if vacancy decontrol was the major reason they were doing it."

Mr. Saft also urged that the the threshold on household income for rent-controlled and rent-stabilized units be lowered "to more like $75,000." (Rent controls for apartments renting for $2,000 or more a month that are occupied by tenants whose household income was more than $250,000 for two years running were effectively lifted in 1993.)

He said that if changes were made in rent-regulation that allowed co-op boards to charge higher rents to tenants now covered by rent regulation, then occupants of those rental units would either be spurred to buy their apartments, or they would pay the higher unregulated rents, which would go into the co-op's coffers.

"Either way, co-ops get bailed out," he said.

GRAPHIC: Photos: Queens: 143-150 Hoover Ave., Briarwood -- Because a high percentage of rentals had made it difficult for her co-op to refinance its mortgage, Loretta Kriaris limited number of rentals; policy was overturned by her board's successors.; Manhattan: 120 East 87th Street -- Joanna Townshend-Boegner, an apartment owner, feels that her building is not being maintained to the standard it would be if there were considerably more owner-occupants. (Photographs by Andrea Mohin/The New York Times) (pg. 1); Stuart Saft, chairman of the Council of New York Cooperatives. j(Chester Higgins Jr./The New York Times) (pg. 8)

LOAD-DATE: November 19, 1995

Evidentiary Exhibit Number 174

The Washington Post

October 14, 1995, Saturday, Final Edition

SECTION: REAL ESTATE; Pg. F06

LENGTH: 2917 words

HEADLINE: REAL ESTATE MAILBAG

BYLINE: Robert J. Bruss, (C) 1995, Tribune Media Services Inc.

BODY:

DEAR BOB: My husband and I have found a house that we like. The seller will carry the mortgage so financing is easy. The big drawback is the house backs up to a major freeway. There is an attractive sound wall, but traffic noise still can be heard inside the house when the windows are closed.

We can buy with only a 10 percent down payment and the seller will carry the mortgage for five years. Do you think we should buy this house or keep looking? -- Maida W.

DEAR MAIDA: That house you're considering for purchase has two significant drawbacks. The first is the incurable defect of the severe noise from the adjacent freeway. I realize residents get used to such noise, but when you eventually decide to sell the house, this will make resale very difficult.

The second defect is the financing. Five years is too short a time period for you to build much equity in the house so you can refinance when the balloon payment comes due. A 10-year minimum mortgage term would be much safer for you.

I think you would regret buying that house with the incurable noise problem and the poor financing with a balloon payment due in just five years.

DEAR BOB: My mother, age 74, is in very good health. But she barely gets by on Social Security. Her house is worth around $ 175,000 but she is reluctant to sell it because she likes the neighbors and the location. I heard about reverse mortgages. Where can I get more information to see if one might solve my mother's income problem? -- Irene G.

DEAR IRENE: A reverse mortgage sounds perfect for your mother's situation of being house rich and cash poor. For the rest of her life, or until she sells the house, she can receive a fixed monthly income with no monthly payback required. When the house is sold, the loan is paid off.

However, watch out for exorbitant upfront fees charged by some reverse mortgage lenders who, in my opinion, take advantage of elderly borrowers. A good book on this topic is "Your New Retirement Nest Egg" by Ken Scholen, available at local bookstores and public libraries.

DEAR BOB: I own a four-unit courtyard apartment building. We share the central courtyard with an identical building that recently was sold to a woman who lives in one of her units. She says if I don't stop tenants' children from playing in the courtyard, she will build a fence down the middle.

My deed says there is a mutual easement for use of the courtyard. Can my new neighbor build a fence in the middle of the courtyard? -- George P.

DEAR GEORGE: If it is a true mutual easement, neither owner can block the other owner's use of the easement. I suggest you immediately have a local real estate attorney review the situation before the neighbor takes any action.

A letter from your attorney to the neighbor will probably prevent the threatened fence construction. If she does that, however, you probably can get a court injunction ordering her to remove it.

DEAR BOB: We recently bought a lakeside vacation home that we will use in the summer and for winter vacations. Will we lose the tax deductions if we rent it when our family and relatives are not using it? -- Kate R.

DEAR KATE: No. Your mortgage interest and property taxes are fully tax deductible under current tax law. Of course, Congress could change that.

If you rent your vacation home to paying tenants, and your personal use time exceeds 14 days, or 10 percent of the rental days per year, then your deductions do become limited. In addition to mortgage interest and property taxes, then you cannot deduct applicable rental expenses, such as utilities and depreciation, which apply to the rental time if the total exceeds rental income.

Before renting your vacation home, consult your tax adviser to discuss the tax consequences of part-time rentals.

DEAR BOB: I recently bought a condominium as a rental investment. Should I buy or rent furniture for it to get a higher rent? -- Marge S.

DEAR MARGE: No. Most of your prospective tenants have their own furniture. If they don't, they can buy or rent furniture. Of course, you should include a stove and refrigerator, but don't furnish the apartment. You will get a better class of tenant if you rent unfurnished and then you won't have any repair headaches.

DEAR BOB: I recently inherited a 10-unit apartment building from my father. He allowed the tenants to have pets. I want to fix up the but part of the problem is that the big dogs destroy the landscaping because they love to dig.

My father charged $ 100 extra per apartment per month for the pets. If I require the pets to be removed, I would lose that extra rent. What would you do in a situation

where eight out of 10 tenants have either a dog or cat? -- Trisha A.

DEAR TRISHA: Your late father was very smart to cater to pet owners because he thereby raised the monthly income by $ 800. Because the tenants don't seem to mind paying the extra rent, and finding apartments where large dogs are accepted is difficult, you probably will always have a steady supply of replacement tenants. I would stick with your father's policy of allowing pets but charging extra rent.

As for fixing up the building, fresh paint is the cheapest and most profitable improvement you can make. If feasible, perhaps you can put a white picket fence around the front to hide the bare lawn dug up by the dogs.

DEAR BOB: In June, we signed a contract to buy a new home. After the professional inspection showed the house to be in excellent condition, we agreed to raise our good faith deposit to $ 5,000.

One term of the sales contract says the seller is to have possession of the deposit. At the time, we had no objections. But a few weeks later, our realty agent phoned to tell us the title search shows the seller's ex-wife is still on the title to the house. She died a few years ago and now the seller is trying to find her two adult children (from another marriage) to get them to sign quitclaim deeds. Frankly, we're tired of waiting. The seller has spent our $ 5,000 and can't refund it. What should we do? -- Ralph S.

DEAR RALPH: Consult a real estate attorney. Getting quitclaim deeds from the heirs of the late ex-wife's estate shouldn't take this long. Perhaps there are additional problems. If the owner truly can't refund your $ 5,000 deposit, you might consider agreeing to accept a promissory note secured by a mortgage or deed of trust on the house, with regular monthly payments to you.

DEAR BOB: In late August we signed a contract to buy a brand-new home that should be completed by November. The contractor arranged a mortgage and got us approved.

Then, in early September, I was diagnosed with breast cancer. In addition to surgery, I will be undergoing chemotherapy and other treatments and will be off work for an indefinite time, so making the mortgage payment on a larger home would be very difficult for us.

When we notified the builder and asked for a refund of our $ 7,500 deposit, he refused. He said my illness is no excuse for not completing the home purchase.

Since we don't want to move now, what can we do to cancel our home purchase and get our $ 7,500 refunded? -- Wendy T.

DEAR WENDY: Legally, you have a firm contract to purchase the new house and the builder doesn't have to cancel it due to your illness. Morally, the builder should do the right thing, cancel the sale and quickly refund your $ 7,500 in the interests of goodwill. He is in a no-win situation because it is unlikely you now can finance the purchase because of reduced family income.

If the builder continues to refuse to refund your $ 7,500, I would notify the mortgage lender that you are now out of work. This probably will cause the lender to cancel the mortgage approval, thus practically forcing the builder to rescind the sale.

Should the home builder still refuse to refund your $ 7,500, you may wish to retain an attorney and bring a lawsuit for rescission of the sale due to inability to qualify for a mortgage without your income. Just receiving a letter from an attorney that notifies the builder of your planned rescission lawsuit may be sufficient to get your $ 7,500 refunded.

DEAR BOB: I am considering buying an almost-new mobile home located in an excellent mobile home park. I own a house that was been a wonderful investment, although it now needs some repairs. Do you think my buying a mobile home would be a good investment? -- Fred T.

DEAR FRED: No. Most mobile homes depreciate in value, just like your car loses value. A few mobile home owners have profited from local circumstances, such as rent control or scarce availability in desirable mobile home parks, and sold their depreciated mobile homes for more than they paid, but those are limited situations.

Mobile homes can be wonderful places to live if you enjoy the lifestyle. Also, they are usually less expensive to buy and maintain than single-family detached houses. But, as you probably are aware, they usually do not do well in severe weather, such as hurricanes, tornadoes and windstorms.

DEAR BOB: I am getting ready to sell my home. Should I give an open listing to several realty brokers so they will compete to find me a buyer? I might be able to sell the home myself and then would not have to pay a sales commission. Does an open listing sound like a good idea for my situation? -- Raoul R.

DEAR RAOUL: No. An open listing is really no listing. It is an offer to one or more real estate agents to pay a sales commission to the first agent who produces an acceptable buyer. Meanwhile, the seller is free to find a buyer, thereby avoiding payment of any sales commission.

In other words, an open listing creates a race between the agent and owner to find a buyer. Because the agent lacks control over the sale, most agents refuse to work on open listings. There are a exceptions, such as commercial properties and very expensive homes where open listings sometimes work, but I don't recommend open listings.

You'll be better off interviewing at least three successful local agents and, after checking each agent's references of recent home sellers, selecting the best one to receive a 90-day exclusive right to sell listing.

DEAR BOB: Following your frequent suggestion to sell one's old home before buying a new one, we did that. Because our first buyer couldn't qualify for a mortgage, it's a good thing we weren't committed to buying a new home. Now we have sold and moved out of our old home, living temporarily in an apartment complex.

Our problem is that my boss just notified me I am under consideration for a major job promotion and transfer but we won't know until April. To complicate matters, we are concerned about that 24-month deadline after our home sale to buy a replacement so we can avoid tax on our profit. What do you recommend for a confused situation like this? -- Gene W.

DEAR GENE: That's easy. Lease a home with an option to buy. No matter what happens, you have 24 months from the day of selling your old home to buy and occupy a replacement of equal or greater cost to defer your profit tax.

If you don't get the job promotion and transfer, then you can exercise your purchase option and use your lease-option rent credit toward the down payment for buying the home. However, if you get the promotion and transfer, then you either don't exercise the purchase option or, if it is assignable, you can assign it to someone else and perhaps earn a small profit.

To find a home that can be leased with an option to buy, look in two places. With the help of a realty agent, look at homes listed for sale. The best lease-option candidates are usually vacant houses that have been listed for sale several months with anxious owners.

The second lease-option source is the "houses for rent" newspaper classified ads. When you inspect a house you would like to own, ask the owner if he or she would like to lease the house with an option for you to buy it. Offer a nonrefundable consideration for the option that is at least double a normal security deposit and offer an above-market monthly rent. Most landlords find it hard to resist such an attractive lease-option offer.

Next, negotiate a rent credit toward your down payment, if you exercise the purchase option, of at least 33 percent. If you're a shrewd negotiator you can get a 50 percent or even 100 percent rent credit.

DEAR BOB: Over a year ago, my mortgage servicer failed to pay my property taxes on time even though there was plenty of money in my escrow account. When I got a delinquent notice from the local tax collector, I immediately contacted my mortgage servicer and the taxes were paid. However, they deducted the interest and penalty from my account.

When I argued, I got the runaround. I tried deducting the amount from my mortgage payment but it was returned to me and I got a late charge. The amount in dispute is only about $ 210 but I hate to see the mortgage servicer get away with this. What can I do? -- Alicia R.

DEAR ALICIA: If more borrowers got tough with their loan servicers, especially on mixed-up escrow accounts, lenders would shape up. Write your loan servicer one more time, setting a deadline for either crediting your account with the $ 210 or sending you a check.

If you don't get a favorable response and your loan servicer is a bank or S&L, contact their federal or state regulator. If your loan servicer is a licensee, such as a mortgage broker, contact the appropriate state licensing official for help. Small Claims Court in your town is the appropriate place to sue your mortgage servicer since your chances of winning the $ 210 are excellent.

DEAR BOB: I don't have much equity in my home but must sell it because I can't afford the payments. Although I prefer to hire a real estate agent, if I do so there isn't enough equity to pay the sales commission so I must sell my home without any agent.

How much below the asking price should I expect to get? If I set the asking price at $ 175,000, can I expect to get $ 150,000? -- Ann C.

DEAR ANN: There is no answer to your question. If you set your home's asking price at its market value, you should be able to get very close to the full asking price. However, if you overprice the home you either won't get any purchase offers, because buyers will think you're not a serious seller, or you will get purchase offers below the market value to allow room for negotiation.

Before you decide to sell your home alone without a professional agent, please consult several successful local agents about a "short sale." That means the agent gets the mortgage lender to agree to a sale that will net the lender below the balance you owe on the mortgage. Depending on the circumstances, a short sale may solve your problem.

DEAR BOB: My family doesn't get along well. When I die, I want my brother to get my house. But I'm afraid my sister will attack my will, as I have a history of mental and drug problems.

A friend suggests I give a deed to my house to my brother now with instructions he is not to record it until after I die. Is this a good idea? -- Mabel H.

DEAR MABEL: No. Delivering the house deed to your brother now is a very bad idea. A deed that is conditionally delivered is not legally delivered. If your sister attacks it in court, she will probably win on the grounds of defective delivery.

Because you fear your sister will attack your will, due to your past mental problems, a better alternative is to put your home's title and other major assets, such as bank accounts and automobile, into a living trust. You still can control the assets in a living trust, such as buying and selling, but it becomes irrevocable when you die. It is virtually impossible to attack a living trust since it doesn't go through probate. Consult an attorney about establishing a living trust.

DEAR BOB: About two years ago, at Thanksgiving dinner in front of about 10 relatives, my father said he would give my wife and me a run-down cabin he owns with my mother. But the condition was I had to fix it up before they would deed it to me.

I am a carpenter by trade and during my spare time I worked to practically rebuild this shack. Now it is a beautiful three-bedroom home where my wife and I live with our two daughters. But the title is still not in our names. My mom and dad say they are letting us live there cost free, except we pay the expenses, such as real estate taxes, and this is enough.

My dad, a lawyer, says the Statute of Frauds requires a written contract and because there is none, there isn't anything I can do to gain title. Is that true? -- Jerry V.

DEAR JERRY: As a rule, the Statute of Frauds requires any agreement regarding real estate to be in writing if it is to be enforced in court. However, there is a major exception.

When one party begins performance of the contract in detrimental reliance on the verbal agreement, the other party is "estopped" to deny existence of the oral contract. Your situation seems to qualify because you relied on your father's promise and fixed up the run-down shack.

Although it will cause family trouble, if you really want title to that house I suggest you retain a real estate attorney to bring a specific performance lawsuit against your parents. Also, record a lis pendens against the title to effectively prevent refinancing or a sale.

Readers with questions should write Robert J. Bruss at P.O. Box 280038, San Francisco, Calif. 94128.
LOAD-DATE: October 14, 1995

Evidentiary Exhibit Number 175

Newsday (New York)

September 22, 1995, Friday, ALL EDITIONS

SECTION: REAL ESTATE; SINGLED OUT; Pg. D01

LENGTH: 1398 words

HEADLINE: The explosive growth in specialists who manage one-family rental properties hasn't reached Long Island, but brokers are filling the gap.

BYLINE: By Joe Catalano. Joe Catalano is a free-lance writer.

BODY:

MARCH, APRIL, May, June and July were frustrating months for Matthew Kochman. Each month, the tenant in a single-family house in Ronkonkoma refused to pay Kochman $ 1,100 in rent.

The tenant witheld the rent because a pipe froze last winter, damaging the house. But without the rental income, there wasn't enough money to complete repairs. To end the standoff, Kochman took the tenant to court.

In July, a judge ruled that the tenant, as compensation for inconvenience, would not have to pay 1 1/2 months of rent. The judge ordered the tenant to pay the remaining $ 3,850 in installments. The last payment was made several weeks ago.

Chalk up a partial victory for Kochman and the landlord.

No, they aren't the same person.

Kochman, an associate broker at Century 21 Coventry Real Estate in Selden, manages the rental house for its owner, who lives in Florida. Kochman manages about 20 houses in communities near his office.

Property managers do as much or as little as the owner wants, but typically find tenants, collect rent, contract out repairs and maintenance, and keep track of expenses. Managers who specialize in single-family houses, condos and co-op units rather than apartment buildings or complexes represent one of the fastest-growing segments of the industry.

In the last decade, as many as 10,000 people have started doing business as single-unit managers nationwide, said Kittredge Garren, president of the National Association of Residential Property Managers. The 10-year-old trade group, with more than 700 members, has seen its membership increase 50 percent annually in the last few years. Single-unit management blossomed during the recession, when people who couldn't sell their homes or condos were forced to rent them out.

However, Long Island and New York City are untapped markets for professional management services specializing in single units, Garren said. The trade group has no members in the metropolitan area, although it is actively seeking them.

A person who manages a single dwelling on Long Island is likely to be part of a division of a residential brokerage, an employee of a smaller property management company or an enterprising individual, Garren said.

Why haven't more companies specializing in single-unit dwellings popped up here?

Partly because many owners or investors who live in the area prefer to manage their properties themselves, Kochman said.

Another reason: Rental houses are spread over too wide an area to make the business worthwhile for a management company, said Martin Solomon, who manages two rentals in addition to being a commercial real estate broker and a property/casualty insurance broker at Emesco Services Corp. in Hicksville. Most brokers only take on clients near their office, Solomon said.

Another negative: Managing a single unit isn't cost-effective, said Barbara Frechter, owner of Century 21 Glen Jay in Forest Hills, who turns down frequent requests by owners to manage their properties.

Management fees typically are 8 percent to 10 percent of the monthly rent. Repair and maintenance costs are paid by the owner, as are legal fees and other expenses.

Those brokers who do branch into management say they don't expect to get rich. Many consider management a part of the total package a full-service brokerage should offer.

There are some opportunities for revenue enhancement. When a tenant leaves, there's a fee for finding a new one, usually equal to one month's rent. And if the owner decides to sell the property, the manager/broker usually gets the listing - and the commission when it's sold.

When there's a good tenant in place, "management is pure profit," said Rolf V. Mahler, owner of Mahler Realty in Baldwin, who manages about two dozen homes. The manager checks the property periodically, sees that repairs are made as needed, and sometimes makes mortgage payments out of an account set up by the owner.

It's the problem tenants "who don't give a damn about the place" that take up time, Mahler said.

Tenants who give managers headaches aren't just those who cause disturbances or fail to pay rent. Solomon recalled three young tenants in a house he was managing who called his office whenever something went wrong, no matter how trivial. "They couldn't change a lightbulb" and called him everytime one went out, Solomon said. He finally dropped the home from his management list.

When the tenant creates problems, "I don't know if the income is worth some of the headaches," said Gerald E. O'Neill, owner of Harbor Light Realty in Amity Harbor and Massapequa, which manages about 10 units.

O'Neill is one of many brokers who got into management because they had rental properties of their own. Since they already had a network of repair specialists and contractors, as well as computer programs to track income and expenses, it was cost-effective to take on other properties.

Clients often are homeowners who have taken a temporary job elsewhere and expect to return. For instance, O'Neill got one of his management assignments when a homeowner was sent to Saudi Arabia to work on an airfield. The client planned to return as soon as the assignment was over, but instead was sent to another assignment in Florida. The man then called O'Neill and told him to sell the house. After the client's initial visit to O'Neill's office, "I never saw him again," O'Neill said.

Other clients include people who are forced to move - either because their family has outgrown the house or they are being transferred - but can't sell because the house is worth less than the mortgage balance. They decide to rent out the house, hoping that it will increase in value so they can sell it in the future.

Using a management company keeps the relationship between the property owner and tenant on a business level rather than a personal one, managers said. Kochman, a landlord himself, said he is friendlier and less businesslike when dealing with his own tenants than he is with his clients' tenants. For example, his tenants occasionally ask for an extra week to pay the rent because they have a financial problem such as unexpected

bills. "I often give in," he said - and sometimes one week turns into three or four. His client's tenants get no such opportunity; Kochman insists that the rent be paid on time.

Not having to worry about daily problems "gives the owner piece of mind," said Daniel Mironchuk of Ridgewood, Queens, who sensed an underserved niche and began a management business earlier this year for single-unit owners in Queens and Manhattan. Mironchuck, a former real estate sales agent who calls himself a real property consultant, cuts lawns, shovels snow and handles repairs, among other things.

Some managers provide regular reports on the property's condition and profit-and-loss statements for tax filing.

The best way to find a manager who handles single-family houses is to call a real estate agent or management company in the community where the house is located, said Garren.

Some Questions to Ask Prospective Manager

WHAT DOES the owner of a single-family house, condominium or co-op unit need to know before hiring a property manager?

Mark H. Kreditor, who manages 600 units in Dallas and is marketing director for the National Association of Residential Property Managers, suggests that owners ask prospective managers these questions:

-- Who are the manager's other clients? The owner should call them for references.

-- What are the names of tenants in homes the manager handles? Call them.

-- How often will the manager visit the property?

-- What is the fee, and what services are included?

-- Who prepares the 1099 federal tax form that the owner must file each year with the Internal Revenue Service?

-- Will videos, photos or a written report on the property be provided regularly so the owner can monitor its condition?

-- What does the manager know about building mechanics and repairs?

-- Will only licensed contractors and repair people be used?

The property owner and manager should also agree on a maximum amount that can be spent on a repair before the owner must be contacted, Kreditor said.

For information about the National Association of Residential Property Managers, which offers courses on management and attempts to keep members informed on issues, call (800) 782-3452.

- Catalano

GRAPHIC: Newsday color cover photos by Don Jacobsen- 1) Gerald E O'Neill, at an Amityville house his firm manages, is one of many agents who got into the business because they own rental properties. 2) Matthew Kochman, who manages this Ronkonkoma rental house for its Florida owner, took the tenant to court over a rent dispute

LOAD-DATE: September 22, 1995

Evidentiary Exhibit Number 176

Providence Journal-Bulletin (Rhode Island)

September 17, 1995, Sunday, ALL EDITIONS

SECTION: REAL ESTATE, Pg. 1G

LENGTH: 1867 words

HEADLINE: Multifamily home sales rise; owners hold onto properties

BYLINE: DONALD D. BREED; Journal-Bulletin Staff Writer

BODY:

Sales of two-, three- and four-family houses in Rhode Island are at the highest level since 1986. Buyers include both investors and live-in owners but, unlike the boom a decade ago, nobody's trying to get rich quick by holding a property a few months and re-selling.

On the contrary, the most anyone seems to hope for is that prices have at last stablized, after four successive years of declines.

Many of the buyers are, as Woonsocket Realtor Jim Giordano put it, "getting back to their roots, living rather cheaply, as our parents did." In return for being landlords, and forsaking the single-family house with the white picket fence, they "can live almost rent-free," he said.

Southeast Asians and Hispanics are buying multifamily housing in the cities, just as earlier immigrants did.

Investors, on the other hand, are described as waiting for distressed properties to sell at the absolute bottom-dollar - often when a bank decides to take whatever it can get - and then making them habitable for re-sale. In Providence, at least, investors are said to be unwilling to be absentee landlords, chasing tenants for rent and vulnerable to vandalism. Giordano, however, said that in Woonsocket some investors are attracted by prices and interest rates low enough that they can get get good cash flow as landlords.

Sales, as counted by State-Wide Multiple Listing Service, were 562 in the first six months of 1995, up 9.13 percent from 515 sales in the same period last year and 399 in the first half of 1993. In 1986, the median price was $ 70,000. (It jumped 75 percent to $ 110,000 the next year.)

Prices also approach 1986 levels. The median price of two-to-four-family houses in the first six months was $ 83,000, down 9.8 percent from $ 92,000 in the first half last year.

The number of active listing dropped somewhat - to 1,642 at the start of July, compared with 1,804 a year ago - but it's still "a buyer's market; people are very choosy," according to Yannee Doeur of Re/MAX Metro in Warwick.

An increase in sales goes naturally with a decline in prices, as Adam Smith taught us. Yet in some parts of the state - the Blackstone Valley and Newport - sales and prices both rose. And in a few communities, such as East Providence and West Warwick, sales dropped although prices were down.

The biggest increase in sales was in Woonsocket, where there were 57 multifamily sales in this first half this year, up 103.57 percent from 28 sales in the first half last year. The median price rose a little to $ 80,500, up 1.26 percent from $ 79,500.

Woonsocket was one of three communities where more multifamily than single-family houses were sold. Providence and Central Falls were the others. (The greater the sales volume, the more meaningful are the

percentage changes in sales and prices; in communities where there are only a handful of sales, results are skewed.)

Bob Martin of Century-21 Boucher, Martin & Co. thought that the gain in sales came because "people are starting to have some confidence in stability of prices. They're no longer are afraid values will continue to decrease." At the same, though, he said sellers are realizing that prices paid during the boom are history.

" 'I paid this for it,' It takes time to see 'this' has no basis in reality," he said. There's no more 'I'll wait a week, and I'll be okay.' "

Martin said Woonsocket's nominal increase in median price happened because "we're selling nicer houses," not because home values rose. "If anything, it slipped - that's my unscientific, gut feeling," he said. "At best, we're able to maintain prices. The majority of asking prices are down."

Giordano described a multifamily sale he made which, because it had six units, would not have been in the MLS statistics; still, it shows the kind of bargains available. The building had a storefront, which the buyer plans to use, and annual income of $ 26,000 from six apartments. The cost was around $ 80,000.

Central Falls recorded a 58.71 percent increase in median price: from $ 32,450 last year to $ 51,500 this year. Nonetheless, it remains the least expensive community in the state. It was the only Blackstone Valley community were volume slipped: to 18 from 22, down 18.18 percent. (Incidentally, there were just five single-family sales in the first half in this square-mile city.)

Pawtucket had a 32.14 percent gain in sales volume: 74 in the first half, up from 56 a year ago. The median price inched up 2.04 percent to $ 87,500 from $ 85,750.

For its reports, MLS separates Providence's East Side from the rest of the city; the two housing markets are quite different. The capital city without its most affluent section had 215 multifamily sales in the first half, 11.98 percent more than 192 in the same period last year. The median price dropped 3.46 percent to $ 53,000 from $ 54,900.

John Gower of Gower & Co. said multifamily houses "are very hard to sell." Then why are sales up? "Because there's so much on the market," he said. "There's more on the market than ever before."

Providence and Blackstone Valley communities, however, did have homebuyer assistance programs which allowed low-income owner-occupants to buy a multifamily with as little as $ 1,000 down. Providence Plan Housing Corporation assisted about 300 buyers in 1994, said Nick Albanesa, acquisition and marketing specialist for PPHC.

This kind of program eventually helps investors, too. Gower said investors he works with typically look for a house that is uninhabitable - they don't compete for housing that owner-occupants could finance - and buy it for as low as $ 10,000 to $ 20,000. Then they spend some money to bring it up to code and re-sell it to an owner-occupant.

Pawtucket Realtor Norman Beretta said that, also in Pawtucket, investors tend to re-sell what they've rehabbed, rather than keeping for rental income. But just holding a property for quick appreciation? No, Beretta said, "That happened in that crazy market. I see nothing on horizon that if you buy and hold for two years, you will get a 15 or 20 percent return. I can't see it happening in near future with the Rhode Island economy the way it is - plodding."

The East Side of Providence had 20 sales, 10 fewer than last year. The median price rose 3.68 percent from $ 143,700 from $ 140,000.

Newport had 25 multifamily sales in the first half, up 31.58 percent from 19 in the year-ago period. The median price rose 8 percent to $ 135,000 from $ 125,000.

East Providence, by contrast, saw sales tumble 54.55 percent to 10 from 22. The median price was down 21.2 percent to $ 98,500 from $ 125,000.

Luis Mateus, a broker-owner in East Providence, noted that the kind of homebuyer assistance found in some other cities is no longer available in East Providence.

In the past, he said, a lender would allow a prospect to subtract 75 percent of anticipated rental income directly from the PITI (principal, interest, taxes, insurance) payment. Take, for instance, a three-family house, for which the PITI would be $ 1,500. The buyer would live on the first floor and get $ 500 a month from the other two floors, or $ 1,000. The buyer could subtract $ 750 from PITI, bringing it to $ 750.

Now the calculation is different: 75 percent of rental income is added to all other income. In the example above, PITI remains at $ 1,500, and the $ 750 allowed as rental income is added to wages and other income. Since PITI is supposed to be about one-third of total income, the effect is to make rental income worth only $ 250.

Harder to finance

Frank Sullivan, a mortgage originator at Chemical Residential Mortgage Corp., agreed that lenders have made multifamilies harder to finance, "because they've been burned." But he added that there are different policies within the secondary mortgage market. FHA is the best, he said, because it allows 93 percent of rental income to be used in the calculation and doesn't require cash reserves, as most others do.

Faye Sanders, senior vice president for community relations and government affairs at Citizens Bank, said Citizens has a number of mortgage products geared for owner-occupants of multifamily properties, "because we recognize that in the urban areas that's the housing stock."

For non-occupant investors, though, financing is "much tighter," Sanders said, "because of the experience of the '80s" when so many investors lost money and walked away from the houses. Four- to 12-unit buildings are "even more difficult" to finance, she added, "because the rental market is weak right now." There's demand for subsidized rentals, Sanders said, but "most absentees don't have access to subsidies."

Women's Development Corporation of Providence, is one nonprofit developer that does used housing subsidies. Alma Green, president, said there's much demand for apartments at $ 300 a month or lower. That rent level might be possible with a subsidy, she noted, or because the owner has held the property long enough to pay off the mortgage.

People like the mobility you get as a tenant, Green said. "If you own a house, you're grounded." With so many low-paying service jobs, she added, lots of people just can't afford home ownership.

Many of today's urban tenants are from less developed countries, Green said, and have different standards for housing. "Families are more important than a wall switch every 8 feet."

Cranston was one of the communities that followed the state trend: more sales, lower prices. First-half sales this year were 38, up 35.71 percent from 28 a year earlier. Prices fell 16.06 percent to $ 104,500 from $ 124,500.

Vin Fraoli of Century 21-Edgewood Associates said multifamilies are not selling "like hotcakes" but good two- and three-families in Edgewood "get a lot of calls." The appeal of a three-family to an owner-occupant is

that you can "live for free," he observed, and a live-in owner is likely to pay market value for the property. Investors, however, will wait for a real bargain.

Less expensive

In the state as a whole and in most communities, the median price of a multifamily house is lower than a single-family. Some of that can be explained by size; the average multifamily unit is probably lower than the average single-family. However, one floor of a traditional three-decker has about the same square footage as one of the new affordable houses sprouting in the suburbs.

Another factor would be location. Multifamily houses aren't found in the most posh parts of a community.

Still, the median prices suggest that often you can buy two or three units of housing for less than a single-family dwelling - but not everywhere. The median multifamily price is higher than the single-family price in eight cities or towns: Newport, North Providence, North Smithfield, Burrillville, Westerly, Warwick, Coventry and South Kingstown. (In South Kingstown, the comparison is based on one multifamily sale which may not be typical.)

If you look over those communities, it's hard to see what else they have in common. One Realtor, though, suggests that there's a strong rental market in all of them, which can support higher multifamily prices.

NOTES:

A Special Section - Real Estate.

GRAPHIC: Photo: FOR SALE: This multi-family home in Providence is on the market.

Journal-Bulletin, TIMOTHY C. BARMANN

LOAD-DATE: September 19, 1995

Evidentiary Exhibit Number 177

The Virginian-Pilot (Norfolk)

September 2, 1995, Saturday, FINAL EDITION

SECTION: REAL ESTATE WEEKLY, Pg. 8

LENGTH: 1049 words

HEADLINE: COVER STORY: A RUN ON RENTAL HOUSING

BYLINE: MARY ELLEN MILES, SPECIAL TO REAL ESTATE WEEKLY

BODY:

Roy Scott, one of 10 property managers at GSH Real Estate, who manage more than 1,500 rental properties, has found 1995 to be a very successful year.

"For 1995, the sales market for GSH has been down, but the rental business is booming," Scott says. "With interest rates fluctuating, there are a lot of people who just can't afford houses, whether it's due to poor or insufficient credit, or lack of funds to come up with the down payment."

"We can't seem to get enough houses on the market. In most cases, as soon as we have a property agreement signed, it's rented within days. Once listed, the property is made available to over 2,700 real estate agents, who get a bonus every time they rent a house.

"It's a big moneymaking source for agents," he says. "If an agent has a slow house sales year, he or she can make some good money renting property."

Property management has been around for at least 50 years. Owners of rental property who live out of state, who want a real estate company to handle their property, sign an agreement and pay a monthly management fee. This year, property managers have been busier than usual, says Scott.

"We make sure potential renters have a good credit background and we check their previous landlord and employer," says Scott, "and, assuming everything checks out, they can rent the property."

There's no one type of property that rents more quickly, Scott says, whether it's a condo, house, townhouse, duplex, or apartment. For his properties, rent seems to range from $ 500 to $ 1,500 per month.

Another reason in Hampton Roads for people not to purchase property is the large number of military people transferred into the area will not be here long, and don't want to be owners.

Often these people can afford to buy a house, and will pay rent equal to a mortgage payment, but don't want to do so for the year or two they'll be stationed here.

Military housing often has a very long waiting list and may be cramped for some families.

"All leases have a military clause in them," says Scott, allowing them an "out" due to unforeseen military circumstances. Renting is the best situation for transients, says Scott - because they won't have the long term commitments.

Other people, especially seniors, don't want the responsibilities of owning a own house and yard, so renting works well for them.

"The rental business has been so incredibly busy," Scott says, "that we'll often put a For Rent sign in the yard, and before we can get back to the office and list it in the computer, someone will have called on it or even rented it."

Such was the case for Stephanie Brown and her family, who just this month moved to Level Green, Virginia Beach, from South Carolina. Her husband is in the military, and Stephanie had to do some hunting for a new dwelling without him. Her mother accompanied her on one trip to the area.

"We called every apartment complex in the phone book," she says. Brown says she wasn't picky - she just wanted a place with three bedrooms, because they have four children, and a washer-dryer hookup. "The market is hot right now with all the Navy ships coming in. I really had a difficult time finding a place."

In South Carolina, the Brown family lived in military housing, which was very spacious. But here, she says, not only is the housing much smaller, it's very backed up.

The Browns will live in the area for several years but decided to rent for now, "because we're totally new to the area, and I think we'd be foolish to jump in and purchase a home when we're not familiar with our surroundings."

She talked to her neighbors before moving into the Level Green area of Virginia Beach, and got a feel for the neighborhood. "I heard the elementary school is really good," she said. But, "you never really know an area until you move in."

If you buy a house and later decide you don't like the neighborhood or the neighbors, says Scott, you could have a difficult time selling the house and may end up living there a long time.

Scott believes a rental agent needs to go an extra step to keep his clients happy.

"My husband wasn't here," Brown says, "so the real estate company went out of their way to fax papers to him. Mr. Scott told me he'd meet me at the property the day I moved in, since he knew I'd be alone.

"When I moved in, there was something wrong with the toilet and they were so quick about fixing it. The plumber was precisely on time and quick too."

"Buying a house," says Scott, "is the American dream. And, it's a shame when people, especially newlyweds, get really frustrated during the process. When they get rejected because their credit history isn't exactly what the mortgage company is looking for, or they can't come up with the downpayment, they think they can't get what they want.

"But, they can if they rent. People will often get depressed and don't even realize they may be able to rent the same type of house in the very same neighborhood. And, they would get the same advantages, except with taxes, of living in their own home."

R. Clifford Wood, regional director for Long & Foster Realty's property management, says that in 15 years in the business this is the busiest summer for rentals he's ever seen. His company manages about 800 single family dwellings, of which 75 percent are owned by people in the military.

One explanation for the current rental success, says Wood, is the "great influx of people moving here from closed military bases. And, I understand there are a lot more military people who are expected to move into this area, so I don't think our business will be slowing down."

Wood says that not only has the company been able to get higher rent for their houses, but they often receive several applications per property.

"I'm a little mystified," Wood says, referring to 1995's rental increase. "Our sales division is doing well too; usually either sales does well and rentals don't or vice versa, but this year is different. We're going to just keep our fingers crossed and keeping on rolling!"

Wood says from what he's heard, other real estate companies are having a good year, too. "There's enough out there for everybody," he says.

GRAPHIC: Color photo on cover by Charlie Meads, Staff, Stephanie Brown sits with her children...

LOAD-DATE: September 5, 1995

Evidentiary Exhibit Number 178

The Washington Post

August 26, 1995, Saturday, Final Edition

SECTION: REAL ESTATE; Pg. E12; HOUSING COUNSEL

LENGTH: 1076 words

HEADLINE: Homeowners Can Regain Once-in-a-Lifetime Exclusion

BYLINE: Benny L. Kass

BODY:

Q: I have some follow-up questions to your recent article on exchanging investment property. Suppose the investment property started out as one's principal residence but that during a temporary move lasting more than two years it was rented out.

The opportunity for the once-in-a-lifetime capital gains exclusion of $ 125,000 was lost. Now the owner would like to return to the original residence or sell it and buy other property in which to live.

Can one regain the once-in-a-lifetime exclusion either by moving back to the original residence and living there long enough, or by making a Section 1031 "like-kind" exchange for some other house or condominium and living there long enough to qualify? How long is "long enough"?

A: This is not really a complicated issue. Let us first examine some basic concepts.

The tax laws differentiate between one's principal residence and one's investment property. There are different tax treatments -- and tax benefits -- depending on which category the property is considered.

Oversimplified, for your principal residence, there are two important tax benefits involved in a sale:

First, the capital gains rollover: If the property is your principal residence, when you sell it you can defer the gain (profit) you have made if -- within two years -- you buy another principal residence that's valued at the same as or more than your old house. It makes no difference whether you buy or sell first; what is important is that no more than two years can elapse between the purchase and the sale. Many people roll over gains multiple times in their lives.

Second, if you are 55 or older and you have lived in the property as your principal residence for at least three years of a total of five years before you sell, you can exclude up to $ 125,000 of any profit you have made on the sale of your house. This is a once-in-a-lifetime exclusion aimed at helping retirees who are moving to smaller homes.

The tax code treats investment property differently. If your property is an investment -- that is, it's not used for personal purposes -- you can exchange if for another investment property under certain conditions without having to pay capital gains tax on your profit. The basis for tax of your new property, called the replacement property, will be the basis of your old property, called the relinquished property.

Incidentally, the tax laws permit you to exchange any kind of real estate. Thus, you can exchange a rental condominium in the District for a farm in Virginia; you can exchange an office building in Bethesda for a beachfront property in Rehoboth. What is important is that the property be held for "investment purposes," and not used for your personal use and enjoyment.

I would not jump too quickly to the conclusion that your rental property can no longer be considered your principal residence for tax purposes. There are a number of tax court rulings that have held that a property does not necessarily lose its qualities as a "principal residence" when it is rented because the taxpayer has been transferred to another area.

There is no legal definition of a principal residence. The Internal Revenue Service and the tax court have long held that the circumstances surrounding the situation will be crucial in making a decision. If, for example, you kept your voting registration and your driver's license at your old home, even if you were transferred away from the area for several years, you may not lose the ability to call your home your "principal" house. Your intentions are controlling and will be very significant if this issue ever arises in connection with an IRS audit.

If you moved back into your old house, you have the right to reestablish it as your principal residence. You have asked how long is "long enough"? When dealing with the once-in-a-lifetime exclusion, the Tax Code (Section 121) gives clear guidance: "During the five-year period ending on the date of the sale or exchange, such property has been owned and used as his principal residence for periods aggregating three years or more."

If you move back into your house and live there for at least three years before it is sold, you should have no problem claiming the once-in-a-lifetime exclusion.

You also asked whether you could exchange the property under the 1031 like-kind provision and then treat it as your principal residence. This is a more difficult issue, but is a real possibility.

Example: You own investment property with a tax basis of $ 50,000. The property now is worth $ 300,000. If you sell it, you will have to pay a large capital gains tax. Instead, you decide to "swap" it, and meet all of the legal requirements for a section 1031 exchange. Keep in mind that in order to qualify for such an exchange, you must "swap" investment properties for investment properties.

You cannot immediately move into the new property; it must be rented out. But for how long? Unfortunately, there is no definitive answer either in the tax code or from the IRS. Experts vary widely in their opinions. However, I think it is safe to state that if you rent the property for a minimum of 18 months, it probably will be acceptable for you to then move in and establish it as your principal residence.

Keep in mind that you still have to meet the three-of-five-years requirement for the once-in-a-lifetime exclusion. But this does create interesting possibilities. If, for example, you were considering retiring to Florida or Arizona, you could exchange your investment property here for another investment property in your retirement area. You could rent it out for a couple of years, and then move into it -- and call it your principal residence.

Unfortunately, there is one potential hitch. If you now reside in a principal residence that has appreciated considerably in value, you either will have to rent it out or sell it and not take the once-in-a-lifetime exclusion.

The tax laws can be beneficial to taxpayers. You must, however, seek out your own tax advisers and discuss the particular facts of your situation with them. This column cannot give specific legal or tax advice.

Benny L. Kass is a Washington attorney. For a free copy of the booklet "A Guide to Settlement on Your New Home," send a self-addressed stamped envelope to Benny L. Kass, Suite 1100, 1050 17th St. NW, Washington, D.C. 20036. Readers may also send questions to him at that address.
LOAD-DATE: August 26, 1995

Evidentiary Exhibit Number 179

Kiplinger's Personal Finance Magazine

April, 1995

SECTION: REAL ESTATE; Pg. 59

LENGTH: 1332 words

HEADLINE: Down by the Seashore . . .

BYLINE: Elizabeth Razzi; REPORTER: DAWN KOPECKI

HIGHLIGHT:

Or up in the mountains or out by the lake, the glut of vacation homes is mostly a thing of the past.

BODY:

Go to any beach, lake or mountain resort and the scene is the same: For Sale signs. Lots of them.

Some of the signs were planted so long ago that they're sagging and rusting. And still they're propped up, just where they were last summer and the summer before.

Now it's 1995, and you've been Joseph and Mary Ann Adzgery spent $ 300,000 on a custom built home on mortgage in a vacation-home fund. Or you bailed out of the stock market and are sitting on a pile of cash. With all those For Sale signs, resort developments must be a bargain-hunter's paradise, right? Surely the income and tax breaks of a second-home rental would pay handsomely.

Not so fast.

ITEM: In many areas, the vacation-home market has been booming for the past year or two. So don't expect to find many bargains this spring or summer. "The steals and deals are pretty much gone," says John Tuccillo, chief economist for the National Association of Realtors.

That's particularly true of resorts near healthy housing markets. For example, Hilton Head Island, S.C., draws heavily from people living in Atlanta, one of the healthiest housing markets in the country. "The [condo] market on Hilton Head is the strongest I've seen in eight years," says Mark Desjean, a local real estate agent. And in Winter Park, Colo., a ski resort 67 miles northwest of Denver, there were 300 condos for sale in the summer of 1993; by January of this year, there were fewer than 100 condos on the market.

The For Sale signs that never seem to go away are often in front of overpriced properties or undesirable, badly located homes.

ITEM: Rental income can help you afford the vacation home you've always wanted, but unless you've got very little debt to pay on the home, renters won't carry all the freight.

ITEM: The most attractive tax breaks disappeared nearly ten years ago. Current tax deductions are not enough to wipe the tarnish off a bad investment, and they no longer artificially fuel demand and buoy prices. It's real demand from real buyers that's driving the market.

ITEM: Vacation-home appreciation in general may beat inflation, but not by much. And there's a lot of volatility in the investment-home market.

"Historically, yes, there's always been appreciation, but most people don't realize that vacation homes have been iffy and have gone up and down in value," says Martin Shenkman, an attorney and CPA.

But the average experience does not have to be *your* experience. You need to jump in knowing that a second-home purchase, especially in the short term, isn't likely to be a bonanza. But you *can* make money in vacation real estate if you approach a hot market with a cool head.

GO FOR LOCATION

What's true for your permanent residence is true for your vacation home: The single most important predictor of future value is location.

Seashore properties are the perpetual favorites. Mountains are favored by westerners. Midwesterners buy lake properties. But you also need to judge location on a personal and practical level. How's the view? Is shopping close by? Is the condo or homeowners association well run? Will people want to rent there?

Mike and Sue Lindman got prime location when they bought a two-story condo with a loft at the Winter Park ski resort, which rises from a base of 9,000 feet above sea level in the Colorado Rockies. They bought the condo for their own use -- every other Friday night during snow season they load 8-year-old Joe and 4-year-old Emily into the car and make the one-and-a-half-hour drive from their home in Highlands Ranch, Colo., a suburb of Denver.

The Lindmans paid $ 74,000 for their condo two ski seasons ago, and its value has steadily increased since. Lately, values in Winter Park are rising faster than a high-speed ski lift, boosted by Denver's strong economy and booming housing market. In 1993 and 1994, condo prices at Winter Park increased by 25% per year, while prices for detached homes rose 14% per year and prices for vacant land rose 27% per year, according to Don Smith, a local development consultant. "Our market has just gone bananas out here," he says.

For the Lindmans, family values count more than property values, according to Mike. "I don't want to have my kids turn 18 and be going off to college and realize that I didn't do anything with them."

When you buy a resort condominium, as the Lindmans did, your property value will also be influenced by the fiscal health of your condo association. Check out a condominium's financial affairs before you invest in one. You'll also pay a monthly condo fee. The Lindmans pay $ 180, which covers trash removal, water and heat.

BUY WITH THE BOOMERS IN MIND

Your property stands an even better chance of strong appreciation if you buy what's on a baby-boomer's vacation-home wish list, whether or not you're a boomer. The oldest boomers are turning 49 this year, so they're headed straight for their peak second-home years. They will be your resale market for the next two decades.

Here's a description of an early-boomer dream house: roomy yet low-maintenance detached house with two or three guest rooms for vising children and grandchildren, located in a friendly, safe -- even gated -- community, with easy access to golf courses, tennis, fishing and shopping. Suitable for permanent residence at retirement.

Joseph Adzgery and his wife, Mary Ann, should be sitting pretty if they decide to sell their vacation house in Jamaica Beach, Tex., on Galveston Island. The Adzgerys, who are retired, split their time between their primary home in Houston and their vacation home on the shoreline of Galveston Bay. They invested close to $ 300,000 in the custom-built home two years ago, and they're convinced it's gone up in value since.

But if you ask them about appreciation, the talk turns to sunsets and solitude, not finance. They can fish right off their front yard, wave at the 25- and 30-foot boats passing by and marvel at the scenery. "Every day the sky is just filled with the most beautiful sunsets that you could ever imagine," Joseph says.

LET RENTERS HELP

Rental income makes a vacation home more affordable, but it won't pay all the bills. Donnie and Pat Martin of Richmond, Va., rent out the two-bedroom townhouse villa on tony Hilton Head Island, S.C., they bought last year for $ 125,000. The condo association books rentals and manages cleaning and repairs. The Martins and their daughter, Katie, use the townhouse for a week in the spring and another week in the summer. (If owners use an investment property more than that, they jeopardize some of their tax deductions -- see the box on page 60).

The Martins' investment isn't paying for itself, at least not in the short term. "By the time you pay the mortgage, association dues, insurance and utilities, then figure what you take in for rent and add in depreciation and the write-off for expenses, you still net out losing money," says Donnie. He counts on losing $ 100 to $ 150 each month. On top of that, the Martins plan to put another $ 5,000 into fix-ups this year.

But the income flow could look better as they pay off their mortgage and eventually raise the rent. The Martins' development has some of the most famous golf and tennis facilities on an island crazed with the sports, so rental prospects are excellent. In general, says Shenkman, the CPA, because vacation-property values tend to be volatile, vacation-home owners need to focus on the net monthly cash flow.

Donnie thinks his home's value may have gone up by $ 10,000 in the first year alone. He doesn't expect that much appreciation year in and year out, but long term the villa could very well perform better than a lot of other investments, particularly in light of the rental income. There's one more benefit, says Donnie. "I can go and sit in my unit and drink a beer. I can have coffee on the deck. I can't do that with my portfolio."
GRAPHIC: Picture 1, no caption; Pictures 2 and 3, Joseph and Mary Ann Adzgery spent $ 300,000 on a custom-built home on Galveston Bay two years ago. But vacation-home buyers there can spend far less: The median home value on Galveston Island is about $ 65,000., RICHARD BOWDITCH; Picture 4, Joseph and Mary Ann Adzgery spent $ 300,000 on a custom-built home on Galveston Bay two years ago. But vacation-home buyers there can spend far less: The median home value on Galveston Island is about $ 65,000., PAM FRANCIS; Pictures 5 and 6, Prime location has helped boost the value of the Lindmans' condo in Winter Park, Colo., which is an hour-and-a-half drive from Denver., RICHARD BOWDITCH; Picture 7, Prime location has helped boost the value of the Lindmans' condo in Winter Park, Colo., which is an hour-and-a-half drive from Denver., PATRICIA BARRY LEVY; Pictures 8 and 9, The Martins are counting on rental income to help make their Hilton Head villa a winning investment. But they'll have to be patient for the payoff; for now, expenses are outrunning receipts by $ 100 to $ 150 a month, RICHARD BOWDITCH; Picture 10, The Martins are counting on rental income to help make their Hilton Head villa a winning investment. But They'll have to be patient for the payoff; for now, expenses are outrunning receipts by $ 100 to $ 150 a month., SIMON GRIFFITHS
LOAD-DATE: March 21, 1995

Evidentiary Exhibit Number 180

Chicago Tribune

April 1, 1995 Saturday, NORTH SPORTS FINAL EDITION

SECTION: HOME GUIDE; Pg. 15; ZONE: CN; Realty Q&A.

LENGTH: 1613 words

HEADLINE: IGNORE AGE;

SELLER FINANCING IS A SMART MOVE FOR ANYONE

BYLINE: By Robert Bruss, Tribune Media Services.

BODY:

Q-I hate to sell my home where I lived with my late husband for the last 34 years, but it's just too big for me to maintain on a limited income of Social Security plus a small pension. My sons help out financially but I dislike accepting their gifts since they both have families.

A few weeks ago, I listed my home for sale. The Realtor is doing a wonderful job, but he says the market is slow in our town now, although he expects it to pick up in the spring.

My question is about his recommendation for me to carry back a mortgage. As I am 72, wouldn't it be rather dangerous for me to take back a mortgage? What do I do if the buyer doesn't make the payments?

A-Your Realtor gave you an excellent recommendation to carry back the mortgage for your home buyer. Doing so will solve two problems. In addition, you should receive a cash down payment of 10 to 20 percent of the sale price.

Seller financing enables the home to sell quickly for top dollar because the buyer doesn't have to qualify for a mortgage with a tough lender. Also, the excellent interest income can solve your inadequate retirement income problem. In today's market you should be able to get around 9 percent interest. That's much higher than you can earn on a CD at a bank.

If the buyer fails to make the mortgage payments, then you can foreclose. The result will be either you will be paid in full by a bidder at the foreclosure sale or you will get the house back to sell for a second profit. Instead of fearing foreclosure, you should welcome it. But don't get your hopes up because less than 1 percent of homes are lost by foreclosure. But your attorney can handle the details if foreclosure becomes necessary.

Q-My wife and I bought our first house in 1975, lived in it about 10 years, and have rented it to tenants since May 1985 when we bought our second house. We are both well over 60 and plan to sell our first house after my retirement this year.

Can we qualify for that "over 55 rule" $125,000 home sale tax exemption by applying it to our first house instead of our second house? If this is not possible, how can we avoid tax on the sale of our first house?

A-The "over 55 rule" $125,000 tax exemption only applies to the sale of your principal residence. Your first home no longer qualifies since it is not your principal residence.

The only tax break available now on the sale of your "first house" is Internal Revenue Code 1031, which allows you to make a tax-deferred exchange for other investment or business property, such as a rental house, apartments, offices and warehouses.

However, another possibility is for you to move back to your first house and live in it for at least three years before its sale. Then it qualifies for the $125,000 tax break since (1) you are over 55, (2) it would be your principal residence, (3) you will have owned and lived in it at least three of the five years before its sale, as required by Internal Revenue Code 121. Please consult your tax adviser for full details.

Q-Since we qualify for that $125,000 home sale tax exemption, I am trying to estimate if our home sale profit will be below $125,000. Do we use the gross or net sales price? Do we subtract our mortgage balance? What about the approximately $27,000 we spent adding a family room and remodeling our kitchen? Please help.

A-Computing your home sale profit takes three easy steps. First, determine your "adjusted cost basis." This is your original purchase price (including closing costs which were not tax deductible at the time of purchase, such as title fee, attorney fee, notary fee, but not including any fire insurance premium paid) plus capital improvements added during ownership, such as the $27,000 for remodeling and the room addition.

Second, compute your "adjusted sales price." This is your gross sales price, minus sales expenses such as real estate sales commission and transfer fees.

Third, subtract your adjusted cost basis from your adjusted sales price to get your capital gain. If you qualify for the "over 55 rule" $125,000 tax exemption, then your home sale profit is tax-free. Your tax advisor can provide complete details. P.S.: As you can see, the mortgage balance is irrelevant.

Q-1994 was a tax year I wish never happened. My business lost money and our home suffered an extensive fire because of an overheated dryer.

However, my CPA says I still must continue depreciating my four-unit apartment building even though it produces a tax loss that will do me no good. Is this correct?

A-Yes. Regardless whether it does you any good, income tax depreciation must be calculated on depreciable buildings such as apartments. However, any unused tax losses from passive loss rental properties can be "suspended" for use in future tax years.

For most taxpayers who earn less than $100,000 adjustable gross income, they can deduct up to $25,000 of losses from passive activity property which they actively manage. But in your situation where you have zero adjustable gross income, your passive loss is suspended for use in future years which will hopefully be better for you than 1994.

Q-I am on the board of directors of a condominium association. We are confronted by one problem after another. At the moment, our major problem is the recreation complex, which is owned by the developer. He died and his widow is offering to sell it to us for $100,000. That is a very good deal so the board of directors voted to buy it.

Now we learned we will only get a quit claim deed signed by the widow who inherited her husband's assets. Shouldn't we insist on a warranty or other type of deed?

A-I don't blame the widow for agreeing to sign only a quit claim. Such a deed carries no warranties or representations. It conveys whatever title she owns. It can be fee simple absolute title. Or, if the widow's title is defective, it might convey nothing.

However, you should insist the condo association receive an owner's title insurance policy with no major exclusions. A quit claim deed plus an owner's title policy is the best protection you can receive, far better than a warranty or any other type of deed. For full details, please consult your association's attorney.

Q-I was recently divorced after 28 years of marriage. My ex-husband, 62, was ordered to pay me alimony for a year, but after that I am on my own. At age 56 it isn't easy finding a career.

Several of my friends sell real estate and they urge me to sell real estate. However, I'm not sure I am cut out for that. Is there some way I can learn more about real estate before making a mistake and becoming a salesperson?

A-Yes. I suggest you take one or two basic real estate courses at a nearby community college. Real Estate Principles and Real Estate Finance are especially valuable, even if you decide not to sell real estate.

Women do especially well selling homes. Today they comprose a majority of the salespeople in most real estate offices. Real estate has no age barriers, no earnings restrictions, no mandatory retirement, no fixed hours, no discrimination against women, and no salary. Earnings are strictly on commission.

Your real estate sales earnings can be outstanding. I know many real estate salespersons who consistently earn over $100,000 annually. Of course, it takes a few years to become established, but if you are serious about selling real estate, you may soon earn more than your ex-husband.

To get started, write to the Real Estate Commissioner at the state capitol of the state which interests you. Ask for the specific requirements for getting your sales license.

P.S.: After you get your sales license, if you need immediate income start in the rental department of a busy brokerage renting homes and apartments. If you do a good job for your rental clients, when they are ready to buy a home they will call you to sell them a residence. Meanwhile, rental commissions will start rolling in as soon as you rent your first house or apartment.

Q-As a Realtor, I must disagree with your constant recommendation for home sellers to sign only 90-day listings. I find it takes several weeks to get a house listed with the local Multiple Listing Service, arrange tours for local salespeople, have brochures printed, and arrange advertising. With an average days-on-market in our town of 98 days, a 90-day listing is too short. When are you going to become realistic and recommend 180-day listings?

A-Never! I'm sure you do a first-class job of marketing homes for your sellers, but I wish you could read the sad letters I receive from home sellers who signed long six-month listings with lazy agents.

When I was actively selling real estate as a broker, I liked 90-day listings because I know realty agents work hardest, smartst and fastest just before a listing is ready to expire. Today, when I list a rental house for sale with another broker I only sign 90-day listings. The agents always get my houses sold.

Although your town has a 98-day average time on the market, I hope you are not an average salesperson. Please consider your customer, not just yourself. Ninety-day listings are best for home sellers. If you won't accept a 90-day listings, many other agents will.

Robert Bruss' report "How Realty Buyers, Sellers and Agents Can Profit from Lease-Options" is available for $4 from Tribune Media Services, 435 N. Michigan Ave., Suite 1408, Chicago, Ill. 60611.

Please note: Real estate laws differ from place to place, so you should check local laws before making decisions on real estate problems. Letters should be addressed to Tribune Real Estate Features Service, P.O. Box 280038, San Francisco, Calif. 94128.

LOAD-DATE: April 1, 1995

Evidentiary Exhibit Number 181

The Boston Globe

February 19, 1995, Sunday, City Edition

SECTION: ECONOMY; Pg. A1

LENGTH: 1618 words

HEADLINE: Multi-family comeback;

First-time buyers often start looking foe single-family homes.. until they see the numbers

BYLINE: By Mary Sit, Globe Staff

BODY:

When the real estate market stumbled in 1989, two- and three-family houses were white elephants.

Today, multi-families are hot properties, in part because first-time buyers who start out looking for a single-family house, have discovered that the rental income can help qualify them for a loan. In addition, a combination of declining prices, relaxed underwriting guidelines, rising mortgage interest rates and a shrinking inventory of single-family homes has helped spur sales.

Last year in Greater Boston, 2,147 two- to four-family houses were sold - 56.1 percent more than 1993 - at an average price of $ 159,192, according to the Greater Boston Real Estate Board's Multiple Listing Service. Statewide, sales increased 26.8 percent in 1994 over the previous year, while total dollar volume declined 22 percent, says the Massachusetts Association of Realtors. In the city of Boston alone, sales of two-families jumped from 531 in 1993 to 833 sold in 1994, according to the city's Public Facilities Department.

"The two- to three-family home is really the affordable housing for the Boston area," says Joseph C. Benoit, co-owner of Century 21 Benoit Realty Inc. in Somerville and board member of the Massachusetts Association of Realtors. "That got lost a little in the shuffle of the confusion of the real estate market a couple of years ago. But they're coming back very strong, back to their traditional place as homes, particularly for first-time home buyers."

Investors who saw the value of two- and three-family houses drop began to dump the houses out of their portfolio, creating a turnover of property, says Fred Johnson, senior vice president of Shawmut Mortgage Co. In 1990, prices declined 17.4 percent from the year before and continued to slide until last year, according to the MLS.

Consider the case of Dorothy and Chris Greco. Dorothy, 34, is a full-time mother of their one-year-old son and a freelance photographer. Chris, 31, is a part-time teacher and part-time playwright.

Last fall, they bought a two-family, century-old house in Jamaica Plain after looking at more than 150 houses in 14 months. A two-family house gave them the space they wanted at a price they could afford.

They paid $ 178,000 for the house, obtaining a 30-year-fixed mortgage at 8.1 percent interest. The rental income of $ 750 from their downstairs apartment pays about half of their monthly mortgage payment.

"We're committed to the area, and we want to have more kids. We bought it for more space," says Dorothy Greco. "You have to think hard . . . Do you have the time and energy and extra resources to keep the place up? Yes, we got a big house and more than if it were a single-family house. But it's going to be a bear to paint this house."

Real estate agents say the Grecos fit the typical profile of last year's buyers of two- and three-family houses: a young couple buying their first house. Ninety percent of the buyers of two- and three-family houses are first-time buyers, agents say.

One of the most striking factors that fueled the huge increase in sales was the change in the underwriting guidelines of the Federal National Mortgage Association. In 1992, Fannie Mae relaxed its underwriting criteria, allowing smaller down payments and a more generous formula for calculating rental income. For example, the down payment requirement for a two-family decreased from 10 percent to five percent.

That same year, sales of two- to four-family houses in the greater Boston area jumped 27 percent from the previous year. Simultaneously, prices declined 10 percent to $ 167,622 from the year before, giving buyers on a budget a bargain.

Massachusetts' stringent lead paint law also kept some buyers at bay, but the state's approval of new regulations in December 1993 eased the burden on homeowners. By allowing homeowners to cover potentially dangerous lead paint with a special liquid coating - a process called encapsulation - costs could be reduced 25 to 30 percent from the average removal cost of $ 4,500.

Consumers became more willing to take the risk of buying an old house with lead paint, agents say.

"Many (buyers) had inspections for lead paint. Then when they were going to do remodeling, they would know where it was. They took that into consideration, and some negotiated it in the price," says Marilyn LaRosa, president of LaRosa Real Estate Inc. in West Roxbury.

First-time home buyers often start out looking for a single- family house until they see the numbers. A two-family house may come with a higher price tag - but with the rental income, the monthly mortgage is often lower than with a single-family house.

For example, take a single-family house at a sales price of $ 160,000. A 10 percent down payment leaves a $ 144,000 mortgage. If a homeowner pays $ 1,600 a year in taxes, the total monthly payment of principal, interest and taxes totals $ 1,397.

Now, take a two-family house for sale at $ 195,000. With a 10 percent down payment, that leaves a $ 175,500 mortgage. Let's say taxes are $ 2,000 a year and rental income $ 800 a month. The total monthly payment is $ 907 - a $ 490 difference in monthly payments.

"This is the type of property a first-time home buyer seeks out," says Benoit of Century 21. "It's more affordable. And it allows them to get into home ownership without it costing as much."

LaRosa in West Roxbury said of the 90 sales in her office last year, 35 were multi-families - about a 50 percent increase over the previous year. She says she now has 20 buyers on a waiting list for a good quality multi-family house.

Mike Foley, regional vice president at Jack Conway & Co. Inc. in South Boston, said sales of three-family houses in his office increased 50 percent in 1994 over the year before - and prices increased 10 to 15 percent.

"There's a bit more confidence in the marketplace in general," says Foley. "The referendum on rent control (which phases out rent control) has really given people a sense that they can once again control their properties. Also, the inventory for single families has gotten low this year because the demand for those are real high. So people who wanted to buy jumped into a two- and three-family."

Last November, voters adopted a referendum abolishing rent control, and in January the legislature passed a bill to gradually phase out rent control over two years. Renters who are 62 or older or handicapped and living in a rent-controlled unit are protected if they earn less than 80 percent of Greater Boston's median income. Rent control for these people ends Jan. 1, 1996, if they live in a three-family building or less, a condo or an owner-occupied building of 4 to 12 units.

Rent control has ended for all "decontrolled" units in Boston. Rent in rent-controlled units can be increased 5 percent every year, or up to 30 percent of the tenant's income. Rent control ends for all units on Jan. 1, 1997.

LINK, a real estate information service which tracks sales in Back Bay, Beacon Hill, Boston, Charlestown, the North End and the South End, says 1994 sales increased by 43.7 percent to $ 13.8 million over the year before. The average sales price also eased up to $ 300,000 over $ 253,000 in 1993.

"The average selling price increase indicates a renewed confidence in the investor market," says DebraTaylor, owner of LINK. "It's a long-term stable investment."

In Cambridge and Somerville, the supply of two- and three-family houses has been steadily declining in the past two years, says Davis Rowley, senior vice president at Hammond/IRB/Ellis & Andrews. Last year, 122 multi-families were sold compared to 156 multi-families sold in 1993, according to the Rosenoff Report.

"With the rent control going away, you'll see a lot of people convert multi-families into condo units. They can convert to condo and sell and get out. Or they can raise the rent if they are owner-occupied," says Rowley.

But buyers who decide to buy a two- or three-family house need to be prepared for the responsibilities of being a landlord and performing regular maintenance, warn real estate professionals.

"We're concerned about getting people in a house - and then, long-term keeping them in," says Florence Hagins, co-chairwoman of The Homebuyer's Union at the Massaschusetts Affordable Housing Agency. MAHA conducts post-ownership classes that cover everything from evictions, choosing a good tenant, checking the heating and plumbing systems and finding a reliable contractor.

Dorothy Greco of Jamaica Plain says that three months after moving into their house a rainstorm damaged the roof and ceiling and caused electrical problems. It cost $ 2,300 to fix the roof and ceiling. Dorothy Greco and her father did the electrical work themselves.

"Having just made it through buying a house, it's not like we had big cash reserves," says Dorothy Greco. "Neither of us is terribly skilled in terms of practical things. It takes more time than I thought, and it takes more work."

Hagins says homeowners should conduct house inspections twice a year. For those who need technical assistance, Hagins suggests the Boston Building Materials Coop, which offers weekend workshops to members.

Lynette Fields, who bought a three-decker in Dorchester in 1990, says she wishes she had taken a few post-ownership courses when she first purchased her house.

"You are always going to have problems," warns Fields, a single mother. "If I had known to have an outside inspector (come in), a lot of things I'm now doing would have been done before I moved in."
SALE PRICES OF MULTIFAMILY HOMES IN GREATER BOSTON

Source Greater Boston Real Estate Board
GRAPHIC: PHOTO CHART, Dorothy and Chris Greco with son, Anthony, found they could afford two-family home in Jamaica Plain. GLOBE STAFF PHOTO/YUNGHI KIM

LOAD-DATE: February 22, 1995

Evidentiary Exhibit Number 182

THE KANSAS CITY STAR

Kansas City Star (Kansas & Missouri)
January 24, 1995 Tuesday METROPOLITAN EDITION
SECTION: TUESDAY BUSINESS; Pg. D38
LENGTH: 795 words

HEADLINE: Living trust the best way to see a minor gets full inheritance; Joint-tenant title with teen-ager would impede title transfer.

BYLINE: ROBERT J. BRUSS

BODY:

I am a widow with a wonderful daughter, age 13. I am worried that if something should happen to me she might get cheated out of her inheritance by her older brother, 22, since she is a minor. If I put her name on the title to my free-and-clear house, as a joint tenant with right of survivorship, will this protect her?

A minor can receive title to real estate but cannot convey it. Adding your 13-year-old daughter as a joint tenant co-owner of your home could be a major mistake if you should decide to sell that house. Since she will be unable to convey title until she is 18, it would be necessary to have a court-appointed guardian represent her should you decide to sell.

Please consult your attorney to discuss your alternatives.

Probably the best is to create a living trust with you as the initial trustee and beneficiary. The living trust can specify the house is to go to your daughter when you die. It will be virtually impossible for your son to attack the living trust terms and cheat your daughter out of the inheritance you want her to have. However, until you die you continue to manage the living trust assets, such as selling or refinancing your home, and you can even change the living trust terms.

I own a four-unit apartment building where I live in one of the apartments. It has been a great investment. But in December one of my long-time tenants died of a heart attack. She had just recarpeted her apartment last August with nice wall-to-wall carpets. Since the apartment had beautiful hardwood floors I gave her permission to install the carpets at her expense.

I estimate she spent about $ 1,500 on the new carpet. Do I have to declare the carpet value on my income tax returns?

No. Unless you made a rent reduction agreement with your tenant, you do not have to declare the carpet cost as income. Tenant improvements are not taxable to the landlord unless they were installed in return for below-market rent or other rent concessions.

But tenant improvements become the landlord's property when the tenant "vacates. " Please consult your tax adviser for further details.

I am considering buying a small income property, perhaps four to six units, where I will live in one apartment and rent the others to tenants. Is there any guideline as to what percentage of gross rental income the mortgage payment should be?

Small-income properties usually make little or no economic sense because the expenses are too high in relation to the rental income.

However, as a rough guideline, the mortgage payment should be not more than 75 percent of rental income, with expenses not more than 25 percent. But that leaves no leeway for vacancies.

As a practical matter, owners of most small income properties are happy if the property breaks even on cash flow. If you will be living in one of the apartments, you cannot realistically expect the rental apartments to pay all the expenses and give you cost-free living.

Two years ago, my husband's business got behind in paying the withholding taxes for his employees. The IRS recorded a tax lien which, we are told, applies to our residence. Is there any way we can sell our home without paying the IRS tax lien?

To be certain the IRS tax lien applies to your personal residence, have a title insurance company check the title. If your husband's business was in one county where the IRS recorded the tax lien, but you live in another county where the IRS didn't record the tax lien, you might be able to sell the home without having to pay off the tax lien. A title attorney can give you full details.

We stupidly bought a home without checking the insulation. After we got two winter heating bills, we discovered our insulation was practically nonexistent. We called the gas company and they recommended several insulation companies. The bids for upgrading our insulation are close to about $ 2,400. As we are short of cash, do you think this would be a profitable improvement? Improved insulation will definitely save you money on your home heating bills. In that regard, it is a "profitable improvement. "

Most home buyers today expect a home to be adequately insulated for the local climate. I am surprised you didn't check the

insulation factor before buying your home. Shame on your real estate agent for not pointing out the home was inadequately insulated. Though insulation doesn't add value to a home, lack of adequate insulation harms a home's sale appeal. Tribune Media Services Inc.

LOAD-DATE: March 15, 1995

Evidentiary Exhibit Number 183

The Roanoke Times (Virginia)

October 31, 1994, MONDAY, METRO EDITION

SECTION: BUSINESS, Pg. A6

LENGTH: 776 words

HEADLINE: SELL OR RENT YOUR HOUSE? IT'S ALL A MATTER OF TAXES

BYLINE: MAG POFF STAFF WRITER

BODY:

Moving into a larger and better home? Buying a smaller house that is better suited to a shrinking family?

If you are leaving your present home, you must determine whether it is in your best interest to sell or rent the property.

Despite conventional wisdom that results in more than 60 percent of American families owning their homes, the Virginia Society of Certified Public Accountants urges homeowners to consider the impact this will have on their tax bill and financial situation.

Many people, of course, are forced to sell.

Selling a principal residence is the best - and often the only - option for those who need the equity in their current home for a downpayment on a new one.

Homeowners who realize profits on the sale of their primary residence may qualify for a special tax break that can help to put their next home within financial reach. The tax law allows homeowners to defer taxes on their real estate gains if they purchase or construct another residence of equal or greater value within two years before, or two years after, the sale of their home.

As an example, the CPAs said, if you realize a $ 50,000 profit on the sale of your home which is taxable at a 28 percent tax rate, you'll be able to defer $ 14,000 in taxes by purchasing another home of equal or greater value within the specified time.

Older homeowners may qualify for an even greater tax break.

Generally, individuals who are age 55 or older before the date of the sale of their home, and who have occupied the residence for three out of the last five years, may exclude from their income a gain of up to $ 125,000 (or $ 62,500 for a married individual filing separately).

This tax break is especially advantageous to people who choose to trade down to a less expensive home and plan to rely on the profits from their house sale to support their retirement lifestyle or other special needs.

Renting a home temporarily, on the other hand, could have some tax ramifications unless it is done carefully.

A homeowner who puts his or her former principal residence on the market, and who then encounters difficulty in selling it, may be able to rent the home for a temporary period and still defer gain on the sale.

The homeowner, however, must demonstrate that the rental is in contemplation of the sale. Otherwise, the personal residence is deemed to have been converted to a rental property, in which case the deferral of taxes on the gain is not allowed.

For example, a homeowner relocated as a result of a job change, puts his or her residence on the market and buys a new home in another city.

After several months, the old residence doesn't sell. Preferring to have the house occupied rather than empty during the sales period, the owner then decides to rent the residence while continuing efforts to sell it.

Under conditions like these, the Internal Revenue Service typically views the owner's rental action as a temporary measure and is likely to allow the gain on the sale of the home to be deferred.

On the other hand, if the homeowner relocated and rented out the former residence without ever trying to sell it, the former residence would most likely be treated as a rental property for tax purposes.

Converting a former residence into a rental property may offer greater financial rewards for many individuals, however.

It gives owners the opportunity to generate steady rental income. Although owners cannot defer the gain on the sale of rental property, landlords are entitled to a wide range of tax deductions that can sharply reduce their tax bill.

Owners of rental property, the CPAs said, can deduct mortgage interest, property taxes and costs associated with operating and maintaining the property, such as insurance premiums, repairs and depreciation.

If there is a net loss on the rental property, this can be subtracted from the owner's gross income, generally up to $ 25,000. Losses that cannot be deducted in the year incurred can be carried over into future tax years.

Because special tax rules apply in the year a property is converted to a rental, the owner may want to consult with a CPA or other tax professional before making the conversion.

Finally, the CPAs recommend that you convert your former residence to a rental only if you're prepared to take on the responsibility of acting as a landlord.

And you must be certain that the conversion will not be detrimental to your financial well-being. You must be sure that the real estate market is favorable enough so that you will keep the property leased and that the market rental will provide a reasonable return on your investment.
GRAPHIC: GRAPHIC: color graphic
LOAD-DATE: November 1, 1994

Evidentiary Exhibit Number 184

The Jerusalem Post
September 30, 1994, Friday

SECTION: FEATURES; Pg. 12
LENGTH: 3070 words

HEADLINE: A HOUSE DIVIDED
BYLINE: Carl Schrag
HIGHLIGHT:

Landlords feel taken advantage of. Key money tenants don't like being accused of getting a free ride. And never the twain shall meet. Box at end of text.
BODY:

Forty years ago, Lea Fletcher paid 2,000 lirot as key money for a 120 sq.m. space underneath a building on Ibn Gvirol Street in central Tel Aviv. At the time, she says, it was nothing more than four walls and a dirt floor. She invested all the money she had, and turned it into a modeling and etiquette school that bears her name.

Under the rules that applied at the time - and remain in effect today - Fletcher's 2,000 lirot bought her the right to use the property for as long as she wanted, provided that she comply with a few basic rules. She did not purchase the property. Rather, she became a protected tenant, with rights guaranteed by laws that were imposed by the British during the Mandate period. Those rights, embodied in the Tenants' Protection Law, afford protected tenants a near-total guarantee against eviction, as well as government-regulated rent increases.

Fletcher pays rent to her landlord - an elderly lady from Hadera - each month. But the rent she pays is a mere fraction of what she would pay on the open market if she moved to the space today, without the benefits of the Tenants' Protection law.

As far as she's concerned, nobody's doing her any favors.

"Do you know what 2,000 lirot was worth back then?" she asks excitedly. "I paid good money, and all I got was four walls and a dirt floor. I installed all of the floors, the electricity, the plumbing and everything else needed to make it a decent work space.

"Of course I pay less than market rent today," she continues. "What do you expect? I paid 2,000 lirot for that right."

Haim Hessman is the son of Fletcher's landlord, and he has handled his mother's affairs ever since his father died. "I inherited this whole mess from my father," he says wearily. "I have no rights in this story, only obligations."

He has an assortment of commercial and residential tenants in two buildings, one in Tel Aviv and one in Hadera, but he reserves his most bitter comments for Fletcher. "She may know how to teach manners, but she certainly doesn't know how to behave."

The case of the modeling and etiquette studio sums up the key money story. Landlords feel taken advantage of. Tenants don't like being accused of getting a free ride. And never the twain shall meet.

Hessman says that from five key-money shops in Hadera, his mother gets NIS 600 in monthly rent. Not from each of them; from all five together. Other landlords speak of apartments that generate an annual rent of just NIS 70.

"The way I see it, I spend thousands of shekels a month to keep my tenants," Hessman says. "There's no point in talking about profit. I spend more on upkeep than I get in rent."

He illustrates that with an example from the family's building in Hadera. When the municipality repaved the sidewalk and installed new light fixtures along the street, he got a bill for NIS 30,000 to cover his share.

"Do you know how many years it will take to get that much money in rent?" he asks. "It's a joke."

Montie Salpeter isn't laughing.

"Why is it called the Tenants' Protection law?" she asks in an impassioned tone. "The image is that the law protects tenants from terrible capitalist landlords, but the truth is that most of the landlords actually are middle-class people, just like the tenants."

She terms the law "a leftover of the socialism of the country's early years," and charges that it has seriously stunted Israel's economic development.

As chairwoman of the Organization for the Protection of Property Rights in Israel, she says that her interest in the issue developed as a direct result of her marriage to Simha Salpeter, whose family owns several key-money properties.

Salpeter paints a picture of his parents as hardworking Zionist pioneers who answered the call to build the emerging Jewish state. They built apartments in Tel Aviv, and rented them out to other Zionists.

Like many other people who built apartment buildings in the 1930s, they didn't put up apartments solely for altruistic reasons. The rent they expected to be paid on the units was supposed to provide them with an income when they retired. When they put up the buildings, they knew that both the market and the Mandatory rules made life very good for landlords.

But apparently the British decided that the situation was too good for the property owners. In the World War II era, they enacted a law guaranteeing tenants' rights. While the old law had denied tenants very basic rights, the new law went to the other extreme, essentially making it just about impossible to evict tenants.

Rent-controlled apartments became so popular that tenants who wanted to move began to take a fee from those who wanted to take their place. Ultimately, the landlords got in on the act, and by the 1950s, the whole system was codified by law. The law provides that when a tenant sells his or her "key," the landlord gets one-third of the sum, and the tenant keeps two-thirds.

The Tenants' Protection Law does not apply to new buildings, but it essentially forced landlords of existing apartments to give their tenants a special, privileged status. What burns up Salpeter most is that some of his parents' oldest tenants never paid a penny for the key, but when they decide to leave their units, they get a share of the sale price.

"They had a lady who lived on Ben-Yehuda Street since the 1930s," he says. "She did not pay a penny to move in, and she paid controlled rent all those years. In 1986, when she left, the incoming tenant paid $ 19,000, and she got two-thirds."

That particular apartment was a small one, he says. He has had tenants who paid nothing in the 1930s and walked away with as much as $ 70,000.

"Why should someone who rented an apartment from my mother in 1940 get a present of an enormous sum of money when he leaves?" Salpeter asks.

Current estimates cited by Salpeter's organization indicate that some 27,000 apartments remain in the key-money pool today, along with some 20,000 businesses.

The organization has lists of landlords who hardly fit the stereotype of ruthless capitalists who want only to take advantage of the poor. The organization says that many landlords live in poverty, thanks to the below-market rents their tenants pay.

Key money isn't a cut-and-dried story of tenants winning at the expense of their landlords. In many cases, landlords do not invest in upkeep. Like Hessman, they say they can't afford to subsidize their tenants any more than the law requires. The bottom line can be rundown, neglected properties that degenerate into slums.

Montie Salpeter blames the Tenants' Protection Law with stunting the economic development of the entire country. She points to a photograph of Tel Aviv's central area and, noting that it is filled with small, old buildings, she says that in any other modern metropolis, the central area would long since have been developed.

A Housing Ministry spokesman concurs, saying that key money has without a doubt stunted the development of city centers throughout the country.

"In Jerusalem, the 'triangle' area formed by Ben-Yehuda, King George and Jaffa streets is filled with key-money stores and apartments," the spokesman says. "It looks like it's from 50 or 60 years out of the past. Central Tel Aviv has pockets with the same situation, and Haifa's Hadar Hacarmel area is the same."

It's not just the largest cities that are affected by key money. Some prime Netanya beachfront real estate has been frozen in time thanks to the law, as have parts of Hadera and other cities around the country.

Housing Minister Binyamin Ben-Eliezer recently appointed a committee to investigate the situation, and sources close to him say that he plans to take serious steps to rectify the distorted situation that has resulted from an old law that has not been updated appropriately.

Official sources contacted for this story were not willing to go on the record concerning the details of Ben-Eliezer's reforms, but at least one expressed confidence that they will lead to far-reaching changes that could even be subsidized by the public kitty.

The source says that the minister recognizes the economic impact of landlords who hold prime real estate but refuse to develop it. The government might be willing to develop a scheme whereby tenants buy ownership for a minimal sum, with the government making up the difference to the landlords - a plan that could total millions of dollars. However, projections indicate that accelerated economic development of central areas would bring enough increased government revenues to more than offset the one-time cost.

Despite the optimism in some quarters, landlords seem unmoved by the establishment of yet another committee. Hessman says too many committees' recommendations have been ignored. "Every committee has come out against key money," he says, "but the recommendations are never adopted. Why should this time be any different?"

Ben-Eliezer may have put key money on his priority list, but that doesn't mean he'll be able to do much on this explosive issue. MK Ori Orr terms it "a lot of old battles," and candidly admits that most politicians will make an elementary electoral calculation: are there more landlords or more tenants among potential voters?

"It's a legitimate consideration for a politician," Orr says, adding that he has forwarded questions about the issue to the Housing Ministry and intends to pursue it.

The issue is clearly charged with emotion and economic interest on both sides. One tenant, who requested anonymity out of fear that his landlord could use anything he says against him, admits that the three-room Tel Aviv apartment in which he lives would rent for $ 600 on the open market. He pays $ 50.

"I was born in this apartment," he says. "My parents lived here since 1948. I don't know what the procedures were back then; I don't think they paid for the key, but I'm not sure.

"If you ask me if I'd like the law to change, I obviously would say no," the same tenant continues. "If I was the landlord, obviously I would want changes."

He attributes today's distorted situation to the fact that many years ago, the government intervened in contractual agreements between two private parties. "That was bad, but it's a fact," he says.

As a result of that decades-old government intervention, the tenant says, many landlords do not take proper steps to maintain and improve their properties. "Why should they, if there is no economic incentive to do so?"

The likelihood of change coming from elected officials seems to dim somewhat when you consider that some politicians have a personal stake in the issue. When Menachem Begin moved to Jerusalem to occupy the Prime Minister's Residence in 1977, he left a key-money apartment on Rosenbaum Street in Tel Aviv. Upon leaving the building, Begin sold his key back to the apartment's owner. Thereafter, the apartment returned to the private market, but not before the Begin family had enjoyed protected-tenant status for many, many years.

Another example: the father of Tel Aviv Mayor Ronni Milo had a key-money shop in central Tel Aviv which has since been passed on to his son, Mati, the mayor's brother. Mati today runs a refrigeration business out of the storefront. He takes huge ads in the local press and gives every impression of running a successful enterprise. His bottom line no doubt gets a boost from the fact that he pays below-market rent.

A woman who would identify herself only as Tzipora owns a gift shop named Piccolo in Hessman's Ibn Gvirol building, in Tel Aviv. She entered the business only 10 years ago, and she doesn't know anything about the history of relations with her landlord. "Maybe I do pay low rent," she says, "but why should anyone care?"

Her landlord, Haim Hessman, cares more than most people. "If you go to my building in Tel Aviv," he says from his home in Hadera, "you won't find anybody at home. Do you know why? Because they're all in Switzerland or the Riviera.

"It's sheer Kafka," he adds. "They complain about paying me NIS 120 a month, and then they travel abroad and keep servants."

He has no shortage of stories. "My sister picked up a rent check from a tenant in Tel Aviv recently," he says. "Afterwards, she got on the bus, and it was a driver she knows. She showed him the check and he just laughed. 'I pay double that just for house committee dues!' "

Montie Salpeter concurs, saying, "When I talk to my tenants, I hear that they've just bought apartments for their children. I know many landlords who cannot afford to buy apartments for their children."

How widespread is the situation today? Nobody knows for sure, but everyone agrees that key money is on an irreversible decline.

When a tenant decides to leave an apartment, landlords who have the means try to buy them out. By paying a tenant the two-thirds sales price that he would have gotten had the key been sold, the landlord gains the right to do anything he wants with the apartment, including selling it outright or renting it at open market prices.

The process is a slow one. The Salpeters maintain that tenants in apartments that are subject to rent control tend to stay put for a long time - at least 30 years.

"We have a joke," Simha Salpeter says. "Living in a rent-controlled apartment is a key for a long life."

Like many other landlords, the Salpeters say they race and scramble each time one of their tenants announces his intentions to move. "We don't have the money, but we can't afford not to buy them out," Simha says.

He suspects that tenants sometimes tell landlords that they have found a buyer for their key at an inflated price. That way, they hope to pressure the landlord into matching the high price.

The process of landlords buying keys back from tenants is having an effect on the supply of key-money apartments. A glance at the apartment listings in any weekend newspaper reveals long lists of units for rent or for sale, but only a few come under the key-money heading.

The managing director of Anglo-Saxon's Jerusalem branch, Werner Loval, says that key-money units make up only a tiny fraction of his office's sales. He estimates that within five years the phenomenon will be of marginal importance.

"We list very few key-money units," he says. "When we do find a buyer, the landlord often matches the price, so we have a policy of collecting our commission even if the landlord ends up buying out his tenant."

Various studies conducted during the past few years have shown that a tenant who pays for a key "earns" back the outlay within anywhere from two to five years. After that, the studies show, it's nearly a free ride. Obviously, landlords are as unhappy as the tenants are happy.

Given the situation, many tenants take a tough attitude toward their landlords. Hessman says that no judge would turn a single mother out of her apartment, even if a landlord had a legitimate case against her. His tenants know it as well as he does, and that prompts some of them to taunt him outright.

"I had one tenant who refused to talk to me," he says. "He told me, 'I don't have to listen to a word you say, and I don't have to pay you any rent at all. If you don't like it, go to court.' I didn't, because there's not a judge in the country who would rule in my favor."

(Box) The Key Money Controversy

'In New York, many people who are looking for an apartment slip $ 50 to the superintendent of a building they like, and say, 'Call me if anything opens up here,' " says Simha Salpeter. "That's how key money began in Israel, but it became more much organized many years

The British brought rent control to Palestine in the 1930s. Until then, the laws had been biased in favor of landlords. The Mandatory authorities revised them to favor tenants, primarily by limiting the right to raise rents or evict tenants.

This created a situation in which a rental contract for an apartment was a very valuable commodity. When a tenant decided to move, it wasn't unusual for him to be besieged by people who wanted to pick up his lease. Thus was born the local version of those $ 50 bills in New York.

Salpeter points out that in general it was a period of shortages, and that a black market had existed in nearly every commodity. Unlike the black market for eggs and chickens, however, this one didn't disappear over time.

Gradually, landlords demanded a cut of these finders' fees, and in 1958, the Knesset approved the Tenants' Protection Law, thereby anchoring superior conditions for renters in Israeli law. (It applied only to existing apartments; new units are exempt.)

For most apartments and shops, the law gives the keyholder the right to keep two-thirds of the purchase price when he sells the key. During the period in which he rents, the keyholder enjoys low, regulated rental rates which, in many cases, don't even keep up with inflation.

Proponents of the system - mainly protected tenants - point out that the fee a person pays up-front entitles him to pay lower rent on a monthly basis. But the Organization for the Protection of Property Rights in Israel says that in nearly all cases, the landlord's share of the fee paid for the key equals at most a few years of market-level rents.

"I'm not saying that protected tenants should have no rights," says Haim Hessman, 54, whose family owns two buildings that have many protected tenants. "But that doesn't mean they deserve to live for next to nothing forever. If they pay a sum for the key that equals six years' rent on the free market, let them live for free for that long. Afterwards, their rent should go to market rates."

Over the years, the Knesset has made some changes to the law. The most significant has been steps to remove certain types of business from part of the rent-control provisions. In other words, banks and a variety of other business that occupy key-money properties still enjoy the right to sell their keys, but they pay free-market

That isn't enough for many landlords. Montie Salpeter, who chairs the Organization for the Protection of Property Rights in Israel, puts her goal very bluntly: "My objective is to change concepts. Housing is a commodity, not a social right."
GRAPHIC: 3 photos, Simha Salpeter with his wife Montie: 'Why should someone who rented an apartment from my mother in 1940 get a present of an enormous sum of money when he leaves?' Menachem Begin enjoyed protected-tenant status for many years in this key-money apartment on Rosenbaum Street, Tel Aviv. Piccolo gift shop on Ibn Gvirol: 'Maybe I do pay low rent, but why should anyone care?', Sarit Uziely
LOAD-DATE: October 7, 1994

Evidentiary Exhibit Number 185

Los Angeles Times

April 15, 1994, Friday, Home Edition

SECTION: Business; Part D; Page 1; Column 2; Financial Desk

LENGTH: 1360 words

HEADLINE: A THORNY PROBLEM;
STUNG BY RISING RENT, RESIDENTS SEEK TO BUY MOBILE PARKS

BYLINE: By DEBORA VRANA, SPECIAL TO THE TIMES

BODY:

Among the residents of Sierra Mobile Homes Estates in Huntington Beach, Gerie Kirkpatrick is known as the Rose Lady.

In front of the blue and white home Kirkpatrick and her husband bought in 1982, she cultivates 18 rosebushes that bloom in yellow, pink and white. Scissors hang from a small wooden sign hand-painted to read, "Help yourself to a rose." Her neighbors in the 230-home park often do so -- and no one steals the scissors.

Kirkpatrick, now a widow and retired, owns her mobile home, but she doesn't own the rose garden. And because of escalating rental rates for spaces in the park, she says, keeping the home itself is becoming difficult. "We thought we did such a smart thing when we moved in here, thinking it was a good, affordable place to retire," Kirkpatrick said. "Then we were hit with rent increases. People are walking away from their trailers, and (the homes) are going back to the banks."

The rent for Kirkpatrick's space in Sierra Mobile Homes Estates has climbed to $488 a month from $220 six years ago, she said -- in addition to her monthly payment of $429 on her home. Squeezed by such increases -- which reflect rising property values in recent years -- a growing number of California's mobile home dwellers -- estimated to number more than 1 million -- say they are being forced out. As a result, many are taking advantage of state laws that encourage them to band together and buy the property on which their homes sit.

Besides gaining control of rental rates, residents who own their parks can set policies and regulations, pool their money to improve common areas and build equity they can cash in if they decide to sell their homes.

Local governments are also getting involved, especially in urban counties such as Orange and Los Angeles, to preserve mobile home parks as affordable housing for elderly people such as Kirkpatrick, who live on fixed incomes, and for young, lower-income families.

California's mobile home population has changed dramatically in the last 30 years. During the 1960s, most park residents were elderly people who bought the homes for as little as $15,000, often paid in cash from selling their conventional houses on retirement.

During the real estate boom of the 1980s, working families priced out of the housing market began moving into the parks. Driven by consumer demand, mobile home prices soared.

In the economic downturn and housing industry slump that followed, many of those working people lost their jobs. At the same time, the value of their mobile homes fell because of depreciation and the real estate decline. Homes bought for between $50,000 and $80,000 were bringing only $20,000 to $30,000 when resold, according to the Manufactured Housing Educational Trust, a trade group based in Orange County.

At the same time, rent for spaces in parks began increasing. Sites that rented for $250 a month in the mid-1980s now range as high as $1,000 in coastal areas. Space rents average about $500.

As early as 1986, the state had a program for making low-interest loans available to mobile home park residents. Of the estimated 4,000 parks in California, only about 120 have become resident-owned parks, known as ROPs. But interest in the idea is rising sharply, said John Tennyson, chief consultant to the state Senate's Select Committee on Mobile Homes.

"Rents are going to continue to go up," said Tennyson, whose committee has published a pamphlet titled "Guide to Mobilehome Park Purchases by Residents." "That's the biggest issue driving the trend toward park ownership."

An intergovernmental agency created by the California State Assn. of Counties and the League of California Cities is mailing out this month brochures about a new program called MuniHome.

Under that plan, the agency, which has sold various types of bonds since the 1980s, will offer tax-exempt revenue bonds for cities, counties or nonprofit groups -- such as mobile home residents -- who can then use the proceeds to buy the parks. New York investment bank Lazard Freres & Co. has been chosen to sell the bonds, which will be paid off out of park operating revenues.

"We want to help cities and counties who are interested in preserving existing low-income housing stock," said Dan Harrison, assistant director with the cities league in Sacramento. "It's a tough decision for a city or county to acquire a mobile home park. We're not saying they should, but if they make that decision, we want to help them do it well."

Beyond seeking to ensure a supply of affordable housing, some local governments are getting into the mobile home park market since being drawn into disputes between park owners and tenants.

In Ventura County, which has 23,136 mobile home residents, the Santa Paula City Council was besieged two years ago by angry tenants complaining that park landlords were gouging them on rent. The city's voters subsequently passed a measure tightening rent control laws already in effect, but the owner of one mobile home park sued the city, alleging that the new regulations interfered with his ability to make a profit.

James Taylor, owner of Santa Paula West Mobilehome Park, withdrew his lawsuit and eventually agreed to sell the property to residents for $9.2 million. The city has agreed to supply housing redevelopment bond money, but the purchase has been held up by financial delays.

Interest by a municipality or resident group in buying a park does not guarantee a done deal. Some park owners are not interested in selling.

Gene Pica, an owner of Sierra Mobile Home Estates, said the Huntington Beach property is profitable and "our rents are right where they should be. We're just a mile and a half from the ocean."

"If we do sell, we'll give them first choice," Pica said of the park's residents, who have formed a nonprofit group called Sierra Residents Corp. State law, in fact, requires park owners to notify residents before putting the property up for sale.

But for now, Pica said, "we're just not selling."

Other park owners complain that tenant groups who want to buy them out are either poorly organized or cannot obtain financing.

"The ideal buyer is the tenant," said Richard Hall, a Costa Mesa businessman who is a part owner of Orange County's largest mobile home park, the 29-acre Treasure Island Mobile Home Park on the oceanfront at Laguna Beach. "But they don't have their act together."

In Los Angeles County, which has 105,000 mobile home dwellers, the city of Lancaster has used redevelopment funds to purchase two parks and is negotiating to buy several more of the 33 parks within the city limits.

Several deals have been completed in recent months by nonprofit resident groups. In December, for example, the 268 dwellers at Bayside Village Mobile Home Park in Newport Beach purchased a 279-slip marina and the 56 acres under their homes from Irvine Co. for $12 million.

Industry consultants and even park owners foresee an increasing number of the state's mobile home communities being run as nonprofit operations.

"The whole status of mobile home parks in California is going to change in the next decade, with most of them becoming owned by tenants and cities," said Laguna Beach park owner Hall. "Thirty years ago, it was a good idea to buy your mobile home and set it up on someone else's land. That's not true today."

Indeed, though the term *mobile home* suggests otherwise, owners cannot simply move to a new park where rents are lower, lawyer Gibbs said.

"The industry has changed since 1955 -- it's not Lucille Ball and Desi Arnaz hooking up their trailer to their car," he said. "These things don't move today."

Living Mobile

According to the 1990 census, only 1.8% of Los Angeles County's population lived in mobile homes, the lowest figure in Southern California. In inland counties, the rate was much higher. Riverside had the most in Southern California, at 15.4%.

County	Mobile home population	Percent of total population
Los Angeles	104,985	1.8%
Orange	53,019	3.6%
Riverside	131,338	15.4%
San Bernardino	76,829	7.9%
Ventura	23,136	5.3%
San Diego	83,132	4.9%

GRAPHIC: Photo, COLOR, Mobile home resident Gerie Kirkpatrick in her Huntington Beach rose garden, right. "We thought we did such a smart thing when we moved in here, thinking it was a good, affordable place to retire. Then we were hit with rent increases." KEVIN P. CASEY / Los Angeles Times; Table, Living Mobile

LOAD-DATE: April 16, 1994

Evidentiary Exhibit Number 186

Los Angeles Times

April 3, 1994, Sunday, Orange County Edition

SECTION: Part A; Page 1; Column 5; Metro Desk

LENGTH: 2311 words

HEADLINE: WHEELS TURNING AT MOBILE HOME PARKS IN O.C.

BYLINE: By DEBORA VRANA, SPECIAL TO THE TIMES

DATELINE: HUNTINGTON BEACH

BODY:

Among the residents of Sierra Mobile Homes Estates, Gerie Kirkpatrick is known as the Rose Lady.

In front of the blue-and-white home that Kirkpatrick and her husband bought in 1982, she cultivates 18 rose bushes that bloom in yellow, pink and white. Scissors hang from a small wooden sign hand-painted with the words, "Help yourself to a rose." Her neighbors at the 230-home park often do -- and no one steals the scissors.

Kirkpatrick, now a widow and retired, owns her Huntington Beach mobile home, but she doesn't own the rose garden. And because of escalating rental rates for spaces in the park, she says, keeping the home itself is becoming difficult.

"We thought we did such a smart thing when we moved in here, thinking it was a good, affordable place to retire," Kirkpatrick said. "Then we were hit with rent increases. People are walking away from their trailers, and they are going back to the banks."

The rent on Kirkpatrick's space in Sierra Mobile Homes Estates has climbed to $488 a month from $220 six years ago, she said. That is in addition to her monthly payment of $429 on her home. Squeezed by such increases, a growing number of California's mobile home dwellers, estimated to total more than 1 million, say they are being forced out.

Facing that prospect, many are taking advantage of state laws that encourage them to band together and buy the property on which their homes sit. Besides gaining control of rental rates, residents who own their parks can set policies and regulations, pool their money to improve common areas and build equity that they can cash in if they decide to sell their mobile homes.

Local governments are getting involved, too, especially in urban areas like Orange and Los Angeles counties, to preserve mobile home parks as affordable housing for elderly people such as Kirkpatrick who live on fixed incomes and for young, lower-income families.

California's mobile home population has changed dramatically in the past 30 years. During the 1960s, most park residents were elderly people who bought homes for as little as $15,000, often paying cash for them after retiring and selling conventional houses.

During the real estate boom of the 1980s, working families priced out of the housing market began moving into the parks. Driven by consumer demand, mobile home prices soared.

In the economic downturn and housing industry slump that followed, however, many of those working people lost their jobs. At the same time, the value of their mobile homes sank because of depreciation and the

real estate decline. Homes for which families had paid between $50,000 and $80,000 were bringing only $20,000 to $30,000 as resales, according to the Manufactured Housing Educational Trust, a trade group based in Orange County.

At the same time, rent on spaces in parks began increasing. Sites that rented for $250 a month in the mid-1980s now range as high as $1,000 in coastal areas and average about $500, according to the trade group.

As early as 1986, the state launched a program that made low-interest loans available to park residents. Of the estimated 4,000 mobile home parks in California, only about 120 so far have converted to resident-owned parks -- knows as ROPs. But interest is increasing sharply, said John Tennyson, chief consultant with the state Senate Select Committee on Mobile Homes.

"Rents are going to continue to go up," said Tennyson, whose committee has published a pamphlet titled Guide to Mobilehome Park Purchases by Residents. "That's the biggest issue driving the trend toward park ownership."

This month, an intergovernmental agency created by the California State Assn. of Counties and the League of California Cities will mail out brochures for a new program called "MuniHome." Under the program, the agency, which has sold various types of bonds since the 1980s, will offer tax-exempt revenue bonds for cities, counties or nonprofit groups such as mobile home residents who can then use the proceeds to buy the parks. New York investment bank Lazard Freres & Co. has been chosen to sell the bonds, which will be paid off with park operating revenue.

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Beyond seeking to ensure affordable housing, local governments are sometimes getting into the mobile home park market after being drawn into disputes between park owners and tenants.

In the Ventura County, which has 23,136 mobile home residents, the Santa Paula City Council was besieged two years ago by angry tenants who alleged rent gouging by park owners. City voters subsequently passed a measure that tightened rent-control laws already in effect. But the owner of one mobile home park then sued the city, alleging that the new regulations interfered with his ability to make a profit.

James Taylor, owner of the Santa Paula West Mobilehome Park, withdrew his lawsuit after agreeing to sell the property to the residents for $9.2 million. The city has agreed to supply housing redevelopment bond money, but the purchase has not been finalized because park residents say the price is too high.

Interest by either a city or a residents' group in buying a park does not guarantee a done deal. In some cases, park owners are simply not interested in selling.

Gene Pica, an owner of Sierra Mobile Home Estates where Kirkpatrick lives, said the Huntington Beach property is profitable, and "our rents are right where they should be. We're just a mile and a half from the ocean."

"If we do sell, we'll give them first choice," Pica said of the park's residents, who have formed a nonprofit group, the Sierra Residents Corp. State law, in fact, requires park owners to notify residents first before putting the property up for sale.

But for now, Pica said, "we're just not selling."

Other park owners complain that tenant groups who want to buy them out are either poorly organized or cannot obtain financing.

"The ideal buyer is the tenant," said Richard Hall, a Costa Mesa businessman who is a part-owner of Orange County's largest mobile home park: the 29-acre Treasure Island Mobile Home Park on the oceanfront at Laguna Beach. "But they don't have their act together."

Other park owners say they feel pressured to sell once residents announce their interest in buying.

"I think if an owner wants to sell to the residents, that's fine, but they shouldn't be forced to," said Norman McAdoo, a partner with Busch, Carr, McAdoo in Garden Grove, which owns five mobile home parks in Orange County. "Everyone wants to live in Orange County -- it's California's paradise. (Park) residents are complaining about rents, but nowhere else in Orange County could you get a decent place to live for those prices."

Such different viewpoints can be an obstacle when residents sit down to negotiate a purchase, said Gerald Gibbs, a lawyer with Gibbs, Dunham & Gibbs. The firm, based in San Clemente, specializes in resident-owned parks.

"In many parks, the residents are pitted against the owners over issues like rent and rent control," he said. The owners "resent the fact that these homeowners have banded together and screamed and yelled and got the city to go along with them in terms of financing."

Despite the obstacles, at least two Orange County cities, Garden Grove and La Habra, have already bought mobile home parks with money raised by issuing a total of $35 million in tax-exempt bonds.

In Los Angeles County, which has nearly 105,000 mobile home dwellers, the city of Lancaster has used redevelopment funds to purchase two parks and is negotiating to buy several more of the 33 parks within the city limits.

Several deals have been completed in recent months, too, by nonprofit residents' groups. In December, for example, the 268 dwellers in the Bayside Village Mobile Home Park in Newport Beach purchased a 279-slip marina and the 56 acres under their homes from the Irvine Co. for $12 million.

Other park purchases are being negotiated. In January, mobile home owners in Lake Forest asked that city to co-sign a $6-million loan so they can buy the lease on Kimberly Gardens Mobile Home Park, where 1,300 people live.

Industry consultants and even park owners foresee an increasing number of the state's mobile home communities being run as nonprofit entities.

"The whole status of mobile home parks in California is going to change in the next decade, with most of them becoming owned by tenants and cities," said Laguna Beach park owner Hall. "Thirty years ago it was a good idea to buy your mobile home and set it up on someone else's land. That's not true today."

Indeed, though the name "mobile home" suggests otherwise, owners cannot simply move to a new park where rents are lower, lawyer Gibbs said.

"The industry has changed since 1955 -- it's not Lucille Ball and Desi Arnaz hooking up their trailer to their car," he said. "These things don't move today. Some have stucco walls and tile roofs."

That is all the more incentive for park dwellers to become landowners. Homeowner Kirkpatrick, who paid $42,000 for her home, says she has spent at least $15,000 on improvements. She estimates that she could sell her

home, though, for no more than $25,000, partly because the value of mobile homes has depreciated rapidly in the Southern California real estate downturn.

David Hennessy, president of the Golden State Mobile Homeowners League in Garden Grove, said Orange County, which has more than 53,000 mobile home residents, is especially ripe for purchase by park dwellers. The reasons are high housing costs in general and a lack of any form of rent control, said Hennessy, whose nonprofit group represents 100,000 mobile home owners in California.

Still, park owners' groups question the fairness of state and local backing for purchase of parks by residents.

"Should a city make a gift of public funds to help a couple of hundred people buy property?" asked Vickie M. Talley, executive director of the Orange County Manufactured Housing Educational Trust, a mobile home park owners association. "Just like any other homeowner, they should have to come up with the down payment and make the payments."

Consultant Tennyson of the state Senate Select Committee on Mobile Homes argues that park residents, though, are in a special situation. Mobile homes are the only affordable housing available to many lower-income people, he said, and thus should be protected.

"Mobile homes are something the state should be involved in," he said. "Many of these people are seniors on fixed income. If they are economically forced out of their homes, they will end up on the streets, and the taxpayers will eventually be supporting them."

Among mobile home residents who have succeeded in buying their parks, the consensus is that they made a wise decision.

Ben Hetherington, 64, a former Pasadena police officer who owns a mobile home in the Shorecliffs park in San Clemente, said he and his neighbors are delighted with their $12.8-million purchase, completed in September, 1992.

Each resident obtained a separate bank loan to buy his or her individual parcel of land, and now the 192-home park operates much like a condominium association. It is governed by a seven-member board of directors, of which Hetherington is one.

"You don't pay rent, you control your own park, and you have a say in what work is to be done," Hetherington said. "You don't have to go to someone else and ask for something. We have the security to know we can stay here and control our future."

Profile of Mobile Home Parks

* Number of parks in Orange County: 214

* History: The majority were built during the 1960s and '70s. The county's newest park was built 10 years ago. Most are on leased land.

* Typical space rental fee: $375 to $500 a month

* Average price for a new mobile home: $50,000

* Average resale price: Varies widely according to condition and location. Recent sales ranged from $8,500 to $89,900, with an average of $37,700.

* Glossary: Trailer parks offer little more than a space to park a travel trailer. Mobile-home parks are larger communities with more space between homes and feature recreation facilities such as pools, open spaces and sites for organized activities.

HOW MANY PEOPLE LIVE IN MOBILE HOMES?

According to the 1990 census, 3.6% of Orange County's population lived in mobile homes. In inland counties, the rate is much higher. Riverside had the most in Southern California, with 15.4%.

County	Mobile-home population	Percent of total population
Orange	53,019	3.6%
Los Angeles	104,985	1.8
Riverside	131,338	15.4
San Bernardino	76,829	7.9
Ventura	23,136	5.3
San Diego	83,132	4.9

ANAHEIM, SANTA ANA HAVE MORE MOBILE HOMES

Mobile home units in Orange County by city:

City: Number
Anaheim: 4,304
Brea: 894
Buena Park: 317
Costa Mesa: 1,303
Cypress: 373
Dana Point: 260
Fountain Valley: 395
Fullerton: 790
Garden Grove: 1,944
Huntington Beach: 3,200
Irvine: 968
Laguna Beach: 451
Laguna Hills: 2
Laguna Niguel: 4
La Habra: 765
Lake Forest: 1,228
La Palma: 3
Los Alamitos: 115
Mission Viejo: 7
Newport Beach: 947
Orange: 1,214
Placentia: 537
San Clemente: 423
San Juan Capistrano: 1,212
Santa Ana: 3,830
Seal Beach: 128
Stanton: 1,394
Tustin: 702
Villa Park: 1

Westminster: 2,917
Yorba Linda: 302
Unincorporated areas: 1,024
County total: 31,954

Sources: Manufactured Housing Educational Trust; California Multiple Listings Service; California Department of Finance

Researched by JANICE L. JONES / Los Angeles Times
GRAPHIC: Table, HOW MANY PEOPLE LIVE IN MOBILE HOMES?, Los Angeles Times ; Table, ANAHEIM, SANTA ANA HAVE MORE MOBILE HOMES, Los Angeles Times ; Photo, Members of the Sierra Residents Corp., from left, Gerie Kirkpatrick, Norma Brownell, Diane Thomas and Virginia Alleman, want to buy their Huntington Beach mobile home park, but the owners aren't selling. GLENN KOENIG / Los Angeles Times
LOAD-DATE: April 4, 1994

Evidentiary Exhibit Number 187

Chicago Tribune

November 26, 1993 Friday, DU PAGE SPORTS FINAL EDITION

SECTION: YOUR PLACE; Pg. 19; ZONE: D; Apartments. Where to look. What to rent. How to bargain.

LENGTH: 1743 words

HEADLINE: THE NEW MATH;

IS BUYING ALWAYS BETTER THAN RENTIG?

BODY:

To buy or not to buy? The question perplexing modern-day Hamlets is not of mortality but mortgages.

Homeownership, long upheld as the American dream, enters a new reality. Shifts in both economics and lifestyles have put a new spin on the shelter question, making it tougher to decide whether renting or owning is the wiser fiscal strategy.

"It used to be a no brainer . . . as soon as you could afford to buy, you bought," says Larry Johnson, president of Sterling Financial Advisors in Itasca. But that advice can no longer be doled out so glibly. "You have to look at several things and make sure they all point to ownership," says Johnson. Those things include your tax situation, location of the real estate, mobility and lifestyle.

"The economics have really changed," says Paul Anglin, a partner at the Deloitte & Touche accounting firm in Chicago.

Most experts agree that, in the long run, the numbers still prove it's financially better to own than rent. But-and this is a big but-if you sell before the residence has appreciated enough, you can easily come out on the short end of the stick.

Just the extras involved in a sale-title insurance, transfer taxes, appraisal fees, lawyer's fees-can easily run more than $1,000, say financial planners. Slap a 6 percent real estate sales commission on top of that and you're talking about a lot of cash. And those are just transactional expenses. Upkeep, be it monthly assessments for condos, or major repairs on your single-family home, can keep costs mounting.

Property values

Homeowners in the '70s and '80s were spoiled by annual appreciation rates hitting as high as 20 percent in some parts of the country. It meant they could buy a home, sell a year or two later, cover the cost of transactions and still make money.

Today that's no longer true. Annual appreciation of 3 percent is about as good as it gets. And that's for well-maintained homes in good locations. "Average real estate could remain flat at best and even depreciate," observes Johnson.

"The less time you live somewhere, the less likely you are to recoup your investment," says Geoffrey Goldberg, head of his own accounting firm in Lincolnwood.

There's no magic number, but many in the financial field agree that pulling up stakes before five years is putting yourself at risk.

Some financial experts believe low appreciation is no short-term phenomenon. Some go even farther. "Houses will become like cars. Appreciation is a thing of the past," says Ed Kelley, president of Kelley/Lehr & Associates, Chicago-based asset management consultants.

Tax brackets must be scrutinized carefully, experts warn.

In general, high-income earners will find deductions for mortgage interest and property taxes more meaningful because, thanks to President Clinton's budget and tax package, a lot of folks are facing higher tax bills.

Anglin shows how it works: Take a married couple earning more than $150,000 a year who pay $6,000 in mortgage interest and $4,000 in real estate taxes in a year. Under the old tax bill, after deductions they would have paid $6,900, and their tax savings would be $3,100. Yet under the new tax package, they pay $6,400 and their tax bill is reduced by $3,600. "You're getting more benefits under the new tax bill than the old one," says Anglin.

Yet Johnson adds a caveat. Even though mortgage interest and property taxes become more meaningful in high tax brackets, "it's offset by the amount you can deduct," he says. Not everyone can claim 100 percent of their deductions, a qualifer introduced in 1991 known as "itemized phaseout."

For example, once a married couple's income exceeds $108,450, they lose a portion of itemized deductions.

"You have to look at the specific situation and run the numbers," advises Terry Gaertner, president of Chicago Financial Advisors, a financial planning firm. "Determine the out-of-pocket cost of owning versus renting."

"Even though you're getting a tax deduction, it may not be worth as much as you think," says Goldberg. "The tax situation is more complicated than you think."

Beyond taxes

Talk of the tax advantages of owning your home may be meaningless, though, if you haven't saved a considerable chunk of cash for a down payment. Instead of an extra month's rent for a security deposit, a buyer normally will have to come up with a down payment of at least 10 percent of the purchase price. Lenders like that figure to be at least 20 percent, and if you put down less you'll have a private mortgage insurance premium to pay every month on top of the mortgage principal and interest, property taxes and insurance.

But even if you have the necessary cash to buy a home, weighing the merits of renting versus owning can be a veritable seesaw.

Ownership, for instance, offers greater control over your environment, argue some. You can paint the whole house chartreuse, if you so desire.

But cost control once you're in your home can be a different matter.

Even though rent can escalate, a lease offers fixed costs for a period of time, sidestepping the hassles and expense of repairs. "People tend to minimize the cost of ownership by just comparing rent with mortgage payment," says Anglin.

If you own a condo, your monthly assessment stands a good chance of increasing each year-and there's always the chance you could be hit by a special assessment.

And if you own a house, a roof repair or leaky basement could mean a hefty bill. When you're renting, it's the landlord who takes the risk.

"Obviously, you reap the rewards of improvements you make to the property when you own," says Claireen Herting, a manager at Coopers & Lybrand, a Chicago accounting firm.

Yet, as a landowner, you'll have more responsibilities and are more vulnerable to lawsuits, points out Janet Kovanda, owner of Birmingham Financial Services in Westmont.

Another disincentive to owning stems from the actions of overzealous developers of the '80s. The stock of residential rental buildings has been so plentiful that rental rates have been a bargain in recent years, especially in the upper tiers of the market. In some cases, renting is cheaper than owning, even after taxes, say experts.

"People have it in their heads that owning is better than renting," observes Goldberg. "I'm not saying it can't be cheaper, but it's not automatic."

Johnson believes rents will stay competitive for the next two or three years.

With mortgage loans continuing to be offered at low rates, ownership is more affordable than it has been in years. Yet there's a psychological variable that drives up expense, Herting points out: Home buyers tend to trade up, buying a home that's more elaborate or larger than their rental apartment, and thus spending more on the mortgage payment than they would for the rent.

Add to that the fact that the home-buying process is more of a hassle now than it once was, at least from the lending side, say many financial gurus. "Mortgage lenders are much tighter today," observes Gaertner. There are more forms to fill out, lenders are seeking more information.

In this market, condos are often renters' first stop on the homeownership trail. Yet selling a condo may be more difficult than selling detached housing, especially if the condo is in a large building.

Single-family houses "have their own personality," says Gaertner, who deems condos "a box in the building." If you own a unit in a large building, there's going to be more competition when it comes time to sell, he explains.

So, is it better to continue renting and save to buy a single-family house later on than to buy a condo now? There's no easy answer, say financial pros. "If you're a city person, your options are limited," says Gaertner, pointing to the big gap in price tags for condos and single-family houses in an urban environment. "Condos do sell," he adds. "You just have to be cautious."

Lifestyle also must be factored into the decision.

"Sometimes the numbers say, yes, you should buy a home. But in the '90s, you have to look at ownership differently," stresses Kovanda. When clients tell her they like to travel, buy clothes and eat out, she suggests other investments.

Alternatives such as stocks and international bonds can provide better returns without the headaches of homeownership. Says Kovanda: "Real estate is not the great investment it used to be."

For example ...

Just as the battle cry of real estate agents is "location, location, location," the maxim of financial experts is "situation, situation, situation" when it comes to deciding whether or not to buy a home.

To compare the costs of renting versus buying in one case, Terry Gaertner, president of Chicago Financial Advisers, ran the numbers for us on a North Marine Drive condo he currently owns and rents out.

Note: The computations for buying assume the condo was bought for $58,000 with a 20 percent down payment; a $46,400 mortgage at 7.25 percent interest for 30 years; with $696 in closing costs, allowing for about 1 point and incidental fees. The buyer is in a 28 percent federal tax bracket.

If the buyer put less money down, he would shoulder a higher monthly mortgage payment, but would have a larger tax writeoff, says Gaertner.

Length of stay in a residence is "the biggest single factor"in the decision to buy or rent, he says. With properties appreciating at a slower rate than they once did, the longer a person plans on living in the unit, the better owning looks. That's because it will take longer to recoup the costs of buying the condo.

If tenure is more than three years, ownership probably makes more sense in this situation, says Gaertner. But if tenure is less than three years, it's probably "less hassle to rent."

AINITIAL COST Rent Buy

Security Deposit $725 $0

Down Payment $0 $11,600

Closing Costs $0 $696

Total initial costs $725 $12,296

MONTHLY COSTS

Rent $725 $0

Mortgage $0 $317

Assessment $0 $293

Tax escrow $0 $99

Average repairs $0 $50

Total monthly cost $725 $759

MONTHLY TAX SAVINGS

From interest $0 $81

From real estate taxes $0 $28

After-tax monthly costs

$725 $650

A

GRAPHIC: PHOTOS 2 GRAPHIC
PHOTO: "It used to be a no brainer . . . as soon as you could afford to buy, you bought," says Larry Johnson, president of Sterling Financial Advisors, working here with CPA Aimee L. Swenby.
PHOTO: 'People tend to minimize the cost of ownership by just comparing rent with mortgage payment.' Paul Anglin, partner, Deloitte & Touche. Photos for the Tribune by John Giannini (above) and Hank DeGeorge.
LOAD-DATE: December 7, 1993

Evidentiary Exhibit Number 188

ASAP

Real Estate Today

October, 1993

SECTION: Vol. 26 ; No. 9 ; Pg. 36; ISSN: 0034-0804

LENGTH: 2070 words

HEADLINE: When divorce is the goal equity sharing may have a role; real estate equity sharing; includes related information

BYLINE: Green, Charlie

BODY:

You can profit as you help ex-couples avoid the must-sell-now scenario.

The setting: divortce court. A couple are battling over whether they should keep or sell the house they bought five years ago. If only they had met you earlier, you could have told them a divorce doesn't compel them both to leave the home they love.

It doesn't? The division of property in a divorce generally triggers no tax. But when the home is eventually sold, the person who got the real estate will pay any capital gains tax--all of it, not half. Many divorcing couples decide that it's better to sell the property as part of the settlement and share the tax burden.

But for some couples, you can offer a way around the must-sell scenario. You may be surprised to see that even by helping one spouse not move, there's business in it for you.

Let Them Eat Cake

Take John and Mary. After two years of dating, seven years of marriage, and two children, they've agreed they can't spend one more minute in each other's company.

What can you do for these troubled, confused people? Of course, you can do the usual: Suggest a realistic sales price, tell them about quick improvements that'll pay off, and provide a positive yet truthful picture of the market. But perhaps John and Mary can have their cake and eat it, too. When they pose the question whether to sell or not to sell, the answer may be to use equity sharing.

If you're never used equity sharing, it's simply a way the couple can continue to be joint owners--one as an occupant and one as an investor. Or, one of the two can own the property jointly with another investor. The shares need not be equal.

What will equity sharing do for Mary and John? For one thing, it'll lay out each spouse's present and future equity without forcing an immediate sale.. It'll also provide a tax benefit for both parties. If Mary stays in the home and John moves out, she can take a tax deduction for the mortgage interest she pays, and he can take depreciation on his share of the property. (Remember that investors can depreciate the cost of improvements only.)

Since there are children involved, equity sharing may be the best way to ensure that the children have a roof over their heads and that both parents are involved in maintaining it. If John later decides to sell his interest in the property, he can do so without disrupting Mary's interest.

What if John wants to take his share of the money right away? You can facilitate the transaction by finding an investor who'd like to avoid the hassle of lining up a tenant. If there's enough equity built up, Mary may even be able to take some cash out of the sale.

I know this may sound outrageous, but John and Mary might decide to get back together. If they do, and there's an equty sharing agreement in place, they can leave it as it is. Then when they're next divorced, they're ready to go. Believe me, it does happen.

Where Do You Begin?

A shared quity financing agreement typically runs 15-20 legal-sized pages and tries to cover all possible contingencies. I always start with an outline that lays out all the areas to be discussed.

In general, the agreement should define the percentage of ownership and delineate who has what responsibility for payments, maintenance, and repairs. It should cover what happens if one party defaults, and it can be used to redefine the percentage of ownership if one party can't keep up the payments. (For example, if Mary loses her job and can't make her mortage payments, John can cover for her and, in turn, gain 1 percent more interest in the property for each month he pays her share.)

A good agreement must cover all foreseeable possibilities so that if John and Mary need to sell the home down the road, the division of equity need to be debated again. The agreement should always spell out a time frame for disposal of the property. Otherwise, the occupant could take unfair advantage of the investor by refusing to move or sell. Unless you're an attorney, you should'nt give legal advice. So ask the couple to have the outline reviewed by an attorney and made into a formal agreement. Having an attorney start with an outline that covers the main points can save people expensive legal time. But encourage them to find one who's experienced in equity sharing--not one of the parties' divorce attorneys--or they may end up paying for the attorney's education.

Ah, but There's More

Whatever you do, don't let John and Mary get away with just a handshake. Having a written agreement, signed by both parties, is a must. Internal Revenue Code Section 208A(d)3 says a shared equity financing agreement must be in place before a deed is recorded showing the change of ownership interest. In addition, the interest in the property must be an "undivided interest for more than 50 years." (That's IRS verbiage that means the agreement isn't a lease.)

With equity sharing one or more of the owners can reside in the property, but those who live there must pay rent to the other owners or the transaction can't be classified as equity sharing. Instead, the IRS will classify it as an equity participation mortgage, a type of pwner financing in which the owners don't get the tax benefits of equity sharing. The rules call for the occupant to pay fair market rent. But, typically, the IRS will let investors discount the rent 5-10 percent because the occupant is considered a long-term tenant.

How do candidates for equity sharing determine the percentage of shares? In a normal agreement the percentage is determined by the value of participation: Whoever puts in the most value gets the larger share. For instance, investors in an equity sharing arrangement will calculate the expenses they'd incur over the term of ownership if they owned the property solely. Because the occupant will cover those expenses, negative cash flow is discounted to present value and credited to the occupant side of the ledger.

In this complicated accounting calculation, the investor typically contributes 75 percent of the actual cash for a 20 percent down payment, resulting in a fifty-fifty ownership. (Although the calculation of future value is a

standard practice in developing equity sharing agreements, it might be disregarded in a divorce situation in which the ex-couple will share the equity.)

If you've taken all the proper steps to make sure the agreements is done by the rules, you still have the lender to contend with. Many lenders don't understand equity sharing--and don't want to. Others do, but they forbid any clause in the contract that demands a sale in less than seven years. Recommend that divorcing parties find a lender that knows about equity sharing. Portfolio lenders are often the most flexible, and some actively seek out equity sharing business.

The escrow officer or attorney who handles the transfer must understand what you're doing, too. Again, it's best to use someone experienced in these transactions.

Scenario 1: Half for You and Half for Me

Let's say John and Mary bought their home five years ago for $ 110,000 with $ 25,000 down. Their current mortgage (postrefinance) is $ 85,000 at 8 percent interest for 30 years. Their PITI is $ 670 per month. At the time of the divorce, their tax basis is $ 130,000.

They decide to share interest in the property, with John as the investor and Mary as the occupant. Lenders I've talked with say that as long as both parties' names are on the loan and there's a history of prompt payment, John and Mary's current mortgage shouldn't be called because of the new arrangement. But there may be a problem if things were shaky before the split or if the divorce will make it difficult for one party to keep up the payments.

Mary and the kids stay in the house as 50 percent owner-occupant. John moves on as 50 percent ownerinvestor. Each month Mary pays $ 400 to John as rent for his 50 percent share. For her share of the mortgage payment, she also pays $ 335 per month. She can deduct interest paid (about $ 3,400 per year) from her income taxes.

John's 50 percent share of the residence is now considered an investment. John receives $ 400 per month in rent and pays $ 335 per month as his share of the payment. Assuming a 30:70 percent land-to-improvement ratio, he can take annual depreciation of $ 1,654 on his taxes. (His 50 percent share of the improvement is $ 45,500, depreciated over 27.5 years.)

To ensure that both parties keep up their end of the bargain, the mortgage payments go to a third party, the attorney who drew up the agreement, who forwards a check for $ 670 to the XYZ Mortgage Co.

John and Mary share the cost of property taxes and major repairs--such as a new roof-renovations, or additions. There are provisions that the home will be sold in five years and the equity split fifty-fifty. According to their contract, Mary has first choice to buy John out at that time. If she chooses not to, John can buy her out. As long as both parties agree, they can change any terms they wish. If not, the terms of the agreement prevail.

Scenario 2: Enter the White Knight

Same family, same home. But this time John decides he wants his equity right away. John and Mary sell their home to Mary and an investor for $ 130,000. After having paid the commission, mortgage, and closing costs, John and Mary net about $ 17,000 each.

If John sells his share of the property as his residence, he can use the 1034 rollover to avoid paying capital gains tax on his $ 17,000. If, instead, he converts his share of the property to an investment before selling to Mary and the investor, he can opt for a 1031 tax-deferred exchange rather than an outright sale.

The investor puts up $ 23,400, and Mary puts up $ 15,600. They share closing costs. The new loan is $ 91,000, with monthly payments of $ 750 (PITI). Mary will pay the investor $ 400 per month in rent, and Mary and the investor will pay $ 375 per month each to an intermediary, who will forward the money to the XYZ Mortgage Co. Mary will have 60 percent equity to the investor's 40 percent.

Remember, although the investor is putting in more cash, he's crediting Mary for the future value of her contributions. For a fifty-fifty deal, she could have put in only $ 5,000, but her monthly payment would have been larger. Am accountant who understands equity sharing can create a spreadsheet that'll crunch the numbers for you.

Scenario 3: A Young Single Gets His First Home

Same story. This time John and Mary both want to move out of the house. Mary has a good job with money coming in and doesn't want to pay capital gains tax. John will retain custody of the children and feels he needs his share of the equity from the home now.

As part of the settlement, they split the ownership fifty-fifty, and Mary moves out. Her 50 percent is now investment property. After the divorce is final, they sell the house to Mary (as an investor) and Ralph, a young professional with little savings.

John takes his $ 17,000 over two or more tax years in a time-payment arrangement with Ralph. That gain will be taxed at a lower rate because of John's reduced total income. For a down payment, Mary puts up $ 20,000 plus her share of closing costs, so he takes no cash out of the deal but retains her 50 percent equity.

Ralph makes a $ 6,000 down payment and pays half of the closing costs. He pays Mary $ 400 per month as rent on her 50 percent of the house. Mary and Ralph send their portions of the mortgage payment to an intermediary, who forwards a check to the XYZ Mortgage Co.

Mary has 50 percent equity in a nice home. John has cash in bank. Both need a place to live. Could that mean two more home sales for you?

Don't End Your Equity Sharing Education Here

Equity sharing can give divorcing couples the flexibility to time their home sale and manipulate circumstances to everyone's advantage. But if you're going to recommend equity sharing, you should consider this article just the start of your education. Read other sources of information, such as The Equity Sharing Book, by Diana Bull and Elaine St. James (Penguin Books, 1990). And develop a network of lenders, attorney, and accountants who understand equity sharing. Not only can they help clarify these concepts for you, but they may also be able to refer equity sharing business your way.

GRAPHIC: Other
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Evidentiary Exhibit Number 189

The Washington Post

June 16, 1993, Wednesday, Final Edition

SECTION: SPORTS; PAGE D1

LENGTH: 921 words

HEADLINE: Pollin Considers Selling Capitals;
Leases at Centre Extended, Rents Lowered

SERIES: Occasional

BYLINE: Dave Sell, George Solomon, Washington Post Staff Writers

BODY:

Abe Pollin, who started the Washington Capitals and built Capital Centre 20 years ago, is entertaining offers to sell his National Hockey League team, sources said.

In another development, Pollin said that the leases for the Capitals and Washington Bullets of the National Basketball Association have been revised and extended for 15 years, with the rent for both teams lowered. In addition, Pollin confirmed he had refinanced the mortgage on Capital Centre, and that the arena would undergo a major renovation next year.

Pollin has owned the Bullets since 1964. He reportedly is not considering a sale of the basketball team.

In response to a question about whether the Capitals are for sale, Pollin said, through a spokesman: "I don't speculate on rumors. There have been rumors for years and years. When and if a sale is consummated, we will hold a press conference."

If Pollin were to sell, Capitals President Dick Patrick would have the first opportunity to buy the team, according to Pollin.

Another group interested in buying the team is headed by Peter Karmanos and Jim Rutherford, who are executives with a Detroit-based computer software firm, Compuware Inc.

The last two expansion NHL teams cost each owner $ 50 million.

Pollin addressed a number of issues that have been swirling around the Capitals since the team was eliminated from the playoffs April 28 in a first-round loss to the New York Islanders, which included three overtime defeats.

These issues include:

Will General Manager David Poile remain with the team or consider a possible offer to become the NHL's senior vice president for hockey operations?

Will Coach Terry Murray be retained?

Patrick's role as a potential buyer in any sale.

Physical improvements to Capital Centre, which will celebrate its 20th anniversary in December.

Regarding Poile and Murray, Pollin said, "As of now, there is no change and they are the general manager and coach."

Poile is one of several general managers who are candidates to fill the NHL job. Poile and Commissioner Gary Bettman had a brief discussion about the position in early May.

Poile, who has been the Capitals' general manager for 11 seasons (and been to the playoffs in each one), has one season left on his contract.

Poile has said he would like to remain in Washington for a variety of personal and professional reasons, but that if his status with the Capitals changed, then he would be interested in the NHL job.

Poile reiterated yesterday he would like to stay with the Capitals but felt it was inappropriate to comment further. Bettman likely will fill the job in the next two weeks, sources said.

Murray has been the Capitals' coach since replacing his brother, Bryan, on Jan 15, 1990. The Capitals' record under Terry Murray is 143-111-24. The team went to the third round of the playoffs in 1990, but was eliminated in the first round the last two years.

Patrick, a Northern Virginia attorney and real estate developer, joined the Capitals' organization in 1982 and owns 20 percent of the team. His family has been involved in the NHL for three generations.

Patrick has said previously that he and Pollin have a verbal agreement that he would have first opportunity at buying the rest of the team if Pollin chooses to sell.

Asked last week if he would approach Pollin, Patrick said: "No, not really, but I'm not going to get into this. Sometimes you get interest from people that might like to get involved. But my efforts with the Capitals are geared toward getting ready for next year. If Abe decides he wants to sell, I'll know when -- I think."

Pollin confirmed his arrangement with Patrick.

"Dick will always have the first opportunity," Pollin said.

Patrick has strong business ties in Northern Virginia and about six months ago expressed some interest in the feasibility of a new arena in that area. Pollin quickly responded at the time that the Capitals were going to stay at Capital Centre.

Pollin recently refinanced the mortgage on Capital Centre in order to make $ 8 million to $ 10 million worth of improvements to the facility, sources said. The improvements are expected to concentrate on the concessions areas and the concourse in general. The lease extension, added to the current leases, would hold both teams to the Capital Centre at least to the year 2012.

"We have refinanced the Capital Centre," Pollin said. "As part of the refinancing, an amount of money has been placed in escrow to do some renovations, starting next year.

"As part of the refinancing, a requirement of the lending institution was that the Capitals and Bullets extend their leases for 15 years."

According to sources, the Capitals' rent was lowered significantly and both teams pay minimal rent to the Centre. Pollin owns two thirds of the arena and Arnold Heft, an area developer, owns the other third.

Pollin and Heft often have been at odds over financial matters relating to the Centre. Pollin owns about 70 percent of the Capitals and is the majority owner of the Bullets. The arena and two teams are separate entities.

In 1982, Pollin launched a "Save the Caps" campaign because he suggested the team would move if ticket sales did not increase. The Capitals made the playoffs every year since then and attendance generally rose in successive years.

The highest average attendance was 17,251, which was in the 1989-90 season. Attendance has dropped the past few seasons, with an average of 15,855 going through the turnstiles in the 1992-93.

LOAD-DATE: October 14, 1993

Evidentiary Exhibit Number 190

The San Francisco Chronicle

MAY 19, 1993, WEDNESDAY, FINAL EDITION

SECTION: HOME; Pg. 1/Z1

LENGTH: 2598 words

HEADLINE: The State of Our Real Estate

Interest rates are low, prices are down -- so why aren't houses movi

BYLINE: LYLE YORK, Chronicle Staff Writer

BODY:

Nearly two years ago, Daniel Goldman started thinking about home ownership. Goldman, 26 and single, manager of his own computer company, started looking at houses in the $ 350,000 to $ 600,000 range, but in a desultory way.

He knew that interest rates were down and prices flat, but he figured they would stay down for a while and might even go lower. "I wasn't in a big hurry," he says. "I wanted to find a place that was just right."

This spring, almost two years later, he was still looking.

The rest of the country is climbing out of recession, and the national real estate headlines are burbling like a spring brook. "Home Sales Soar; Prices Begin to Rise." "Now's the Time to Sell."

"Mortgage Rates Drop to 20- Year Low." "Home-Buying Power Hits Highest Level Since 1974." "Now's the Time to Buy."

Don't they read the papers around here?

In the Bay Area, there's no burbling brook, only still water. The California Association of Realtors reports that existing home sales in the Bay Area fell 16.7 percent between the last quarter of 1992 and the first quarter of 1993, and they're down 18.7 percent from the first quarter of 1992. The median home price has risen a tiny .8 percent from the first quarter of 1992 -- from $ 247,340 to $ 249,270.

Stagnant prices, economic uncertainty and plain old indecision have lots of prospective buyers and sellers sitting on the fence, nervously fingering their wallets.

All levels of the local real estate market have been affected by the recession that's still gripping the Bay Area, says Cynthia Kroll of the Center for Real Estate and Urban Economics at the University of California at Berkeley. Flat housing prices are one big factor keeping potential mover-uppers from moving, and first-timers are not rushing into the market as one might expect, even with fixed mortgage rates lower than they have been since 1972.

The buzz among brokers, appraisers, bankers and academic forecasters was that this spring would see the customary upturn in the real estate business -- just because it's spring. But an actual turnaround may not come until the middle of next year, says Terry Kaufmann, assistant director of the nonprofit Real Estate Research Council in Pomona, which issues quarterly reports on the California real estate business.

And the turnaround will be a gradual one, says Kaufmann, not a dam bursting. "Employment's got to get better."

"There are plenty of people looking," says Peter Palmisano, president of Pacific Union Marketing Co., a division of the Bay Area-wide real estate company. Starter houses and condos under $ 300,000, Palmisano says, are selling quite well, and so are the high-end houses -- above $ 1 million -- whose buyers don't have to think too hard about price.

But the midrange market is at a standoff. In the $ 300,000 to $ 1 million range, says Palmisano, "it's no-man's land." "Buyers and sellers are still dancing with each other" -- the buyers won't go any higher and the sellers won't take any less.

"People are taking more time than they used to," confirms Rose Black, an independent broker in Berkeley and Oakland -- and she should know. She is Daniel Goldman's broker, the guy still looking after almost two years.

THE FIRST HOUSE

Ultimately, whether to jump into homeownership is a very personal decision. The state of the market is only one variable.

More important is the state of your bank account, the security of your job and your frame of mind. You should feel genuinely ready to buy a house -- not just let yourself be talked into it by a spouse or a real estate agent. And don't buy now just because interest rates are low and all your friends are doing it.

"If you're ready to buy, or ready to sell, it's probably a great time," says Trevor Paulson, a sales agent for nine years and now a loan consultant for the M Co. in San Francisco.

Deborah and Roy Scott of Berkeley were ready, but at first they couldn't find a house that was ready for them.

Deborah, 38, a family therapist, and Roy, 59, an artist, have a 2- year-old son, Zack. They were lifetime renters convinced they'd never be able to afford a house in the Bay Area. And they were "clueless" about how to go about it.

All they knew, said Deborah, was that "the rates had never been so low -- it was now or never."

They started going to open houses, not sure they could ever find something they liked. Everything in their price range was "ticky-tacky boxy."

Then they went to an open house for a place that was too expensive for them (something the real estate experts tell you never to do). It was in a transitional neighborhood of West Berkeley, but much more house than they'd seen before, priced at around $ 200,000. "We knew the instant we walked in that we wanted it."

For them to afford the down payment, money would have to come from Deb's family. "My father, sister and brother-in-law, and uncle all chipped in. It was a real family effort," Deb says.

Goldman, who was living in Walnut Creek and working in Emeryville, didn't want a long commute. He wanted quiet, some space around his house and a swimming pool. All this wasn't easy to nail down, even at the prices he could afford.

He looked in Orinda and Lafayette, but either houses were too close together or he could hear freeway noise. A couple of times he came close to making a deal -- "where I thought, 'I can make this work, maybe' " -- but his heart wasn't in it. The houses weren't perfect. He feels now, looking back, that they were also overpriced, given the way the market was going.

And he admits that he was also partly a classic nervous buyer, edgy about commitment to a house -- "the settling-down sort of thing."

His broker, though patient and understanding, wasn't sure he'd ever find what he wanted.

SHOULD YOU TRADE UP?

You already own your first house, or your second or third. Is this spring a good time to trade up -- take the equity you've earned and leverage yourself into a bigger house or a better neighborhood?

Your house may have lost value or failed to appreciate much if you bought it in the late '80s or later. The residential real estate market reached its fevered peak and broke in 1989. The most expensive houses -- $ 1 million and up -- have lost as much as 15 percent to 25 percent of their value, according to economist Kroll.

The advice you'll get from real estate people is to accept that things have changed -- cut your losses and look for ways to recoup at the buying end.

For example, suppose you've lost equity through depreciation and the profit you make selling your house won't quite cover the down payment on the move-up house you want. One way to close this gap, suggests Palmisano, is to ask the seller to carry a second mortgage for you for a short term (usually three to five years). That way, the seller gets the money he wants after a few years, and you get the house you want but couldn't quite reach.

Consider the case of Meg and Mark Hill, 31 and 34, who made their move when it looked as if all the numbers were stacked against them.

They'd moved from the Bay Area to Sacramento. Then Mark took a job with a semiconductor manufacturer, which transferred him to the Peninsula. So it was back to the Bay Area -- under the worst possible circumstances.

They were sitting in a three- bedroom, two-bath house in an exclusive neighborhood of Sacramento, whose midrange housing market is "devastated," said Meg, a real estate appraiser. They had bought the house in 1989 for $ 117,000 and invested some $ 50,000 in repairs and improvements. By the time they were forced to sell last year, says Meg, they got only $ 163,000. "We really lost money!"

To make it harder, they were planning to start a family and needed a fairly large place. What could they buy on the Peninsula in their situation?

They had some lucky breaks. Mark's company offered to pay their realtor's commission, loan points and some closing costs, and they got a gift from Mark's parents.

"We ended up with a good deal -- $ 365,000 for four bedrooms, two and a half baths, a pool and spa in Los Gatos," Meg says. "We were very, very fortunate."

Now that they have -- against all odds -- safely traded up, what else is there to worry about?

Plenty. They're worried about their higher property taxes. "We anticipate getting hard hit," Meg says. "And we feel extremely maxed out. What if one of us loses his job? We couldn't make it on one income."

TRADING UP ISN'T FOR EVERYONE

Trading up is a good idea if you're not doing it just to increase your equity. Do it for other reasons: You want more space because another child is coming; you want a town with better schools; you need to shorten your commute.

And to decide whether you can afford the expenses of the trade- up, take a good look at your personal balance sheet.

Howie and Gilbert Holtzman, 40 and 61, live in the Montclair district of Oakland. Howie is a graduate student and Gilbert a physician at Kaiser Permanente. Gil's two older daughters had graduated from Piedmont High; the Holtzmans thought they'd better start thinking about moving to Piedmont or Orinda before their 3-year-old was ready for school.

They discovered, however, that prices in both areas were "exorbitant."

"Piedmont would have cost us at least $ 100,000 more," says Howie, just to buy a house the same size as the one they have.

They now have fairly low property taxes, having lived in their present house for 12 years, but if they moved those taxes would take a huge leap. They also realized there were better ways to invest their money for the long term than in real estate. They're weighing all these factors against the cost of private school for their daughter. And they've decided to stay where they are, at least for the time being.

THE HOLDOUT'S TRIUMPH

And what happened to that eternal seeker, Daniel Goldman? Last week, he closed escrow on his dream house in the Oakland hills on 1 1/3 acres, quiet, with pool -- at the low end of his price range.

The sellers hadn't had any acceptable offers and had gotten discouraged and taken the house off the market. A friend saw an ad for the house in an old newspaper and told Goldman, who swooped in with his bid and snapped up the house. "It was the perfect homebuying experience," he says.

Sometimes it pays to hold out for what you want.

WHAT WENT UP HAD TO COME DOWN

Explaining why real estate is still in the doldrums, Cynthia Kroll of the Center for Real Estate and Urban Economics at the University of California at Berkeley gives a quick economics lesson.

In the go-go '80s, housing prices went up higher than they should have. So did mortgage interest rates. Surprise -- people stopped buying, and prices fell.

We entered a statewide recession that has lasted longer than the national recession. Fortunately, in the '90s, federal monetary policy has kept mortgage rates low -- otherwise, house prices would have fallen even lower.

Sellers lament that they can't make the equity gains they came to expect back in the heyday of the 1980s.

"Here in California, we feel we have a God-given right to make money on our houses," says Nita Miller, an agent for Seville Properties in Menlo Park. "But we have forgotten that this is only if you bought in the right place at the right time.

"We're getting back to the idea that your home is your home -- which I think is very good."

Don't be afraid to sell at a reasonable loss, she advises. "Sellers shouldn't hold out for what their house was worth in '89." At the moment, she says, at least in her sales territory -- Los Altos to Menlo Park -- "selling is totally based on price. If (your house) is perceived as well priced, it's going to sell. Buyers are very nervous about overpaying."

And Miller makes the point all agents are making this spring, which is both a selling point and true: "It's an excellent move-up market if you're willing to sell at a loss -- you can buy at a lower price, too."

RENT OR BUY?

Take these comparisons for what they are -- generalizations. Everyone's situation is different. To help you decide, see a financial expert -- a tax adviser, accountant or loan broker.

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ADVANTAGES OF RENTING

* Your money can be spent on travel, college aid for your kids or a spiffy new car instead of mortgage payments and repairs.

* In a financial emergency, your money won't be tied up in your house.

* Your landlord, not you, has to worry about maintenance, repairs and property taxes.

* Now that appreciation has cooled, other forms of investment will give you a higher return.

* Renting can be cheaper than owning, especially in rent-controlled areas and for luxury apartments.

* If you like or need to move often, renting is advisable; the transactional costs of selling or buying generally take two or three years in the house to recover.

* In the Bay Area, the high cost of real estate means you may have to move to a smaller place than you now rent, or to a less desirable neighborhood, or both.

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ADVANTAGES OF BUYING

* If you're not good at saving money, putting it into home equity is a form of enforced savings.

* Your property taxes and mortgage interest payments are excellent income tax deductions.

* In a financial emergency, you can investigate a home equity loan.

* If you get a fixed-rate mortgage, you have the security of knowing your payments will not go up, and no one will evict you. When you're renting, you have little or no control over rent increases or the possibility of eviction.

* You're free to do murals in your dining room, paint the steps red, change the garden or tear out a wall without a landlord's permission; and you, not the landlord, will profit from any improvements when you sell.

* No one will tell you that you can't have a pet .

THE JOYS OF A 'CONTRACTOR'S SPECIAL'

'It's a terrific time to get into the lower end of the housing market," says Nan Warren, an agent at Century 21/Beaubelle & Associates in Moraga. "With rates so low -- 4 percent for some variable-rate mortgages -- the low-end properties really pencil out now."

And last month, the average 30-year fixed rate fell to 7.38 percent.

Warren hastens to add: "You shouldn't buy a dump, but you can buy a house to live in and fix up, then resell."

One of Warren's recent clients is handy at putting down linoleum and making a "fixer-upper" liveable. The client, 32, who would rather not be named because she's a criminal investigator, already owned a Concord

townhouse. She decided to keep her townhouse, rent it out and invest in a second fixer house to live in, fixing as she went.

She had several reasons: She wanted to move closer to the city, for a shorter commute. She wanted to shelter some of her income -- "Not knowing what Clinton is going to be doing with our taxes, it is a good tax shelter. Having a higher mortgage payment gives you higher deductions." And, she says, "I wanted not to let this market pass me by. It's been such a buyer's market."

She bought a 30-year-old, $ 268,000 fixer in Moraga.

The buying process was not easy. "Buying a house is a very laborious process. Seller's inspection, buyer's inspection -- widely varying estimates -- lots of negotiations, standoff. You're up, you're down, you're up. . ."

Overall, though, she's glad she did it. When it looked at one point as if the standoff would kill the deal, she says, "I wasn't looking forward to starting over. I really liked the house better than others I'd seen; it was worth the process."

GRAPHIC: PHOTO (3),(1) MATCH, Deborah and Roy Scott, with son Zack, loved their Berkeley house despite the cost , BY JERRY TELFER, THE CHRONICLE, (2) UNIQUE, Deborah and Roy Scott's Berkeley house and yard are far from the 'ticky-tacky boxy' homes they looked at , BY JERRY TELFER, THE CHRONICLE, (3) THE QUEST, For nearly two years Daniel Goldman searched for the perfect home , BY LIZ HAFALIA, THE CHRONICLE

Evidentiary Exhibit Number 191

Daily Oklahoman (Oklahoma City, OK)
April 17, 1993, Saturday CITY EDITION
SECTION: REAL ESTATE; Pg. 4
LENGTH: 575 words

HEADLINE: Interest Sparked in Resale Home Market

BODY:

Record low mortgage interest rates, soaring rent prices and relatively reasonable home prices have sparked buyer interest in the resale home market, especially among first-timers, according to the Residential Sales Council of the Realtor's National Marketing Institute.

Bud Engstrom, president of the Oklahoma CRS (Certified Residential Specialist) chapter, said the significant tax advantages and investment benefits, not to mention greater financial integrity and personal satisfaction, are some of the most recognized benefits of home ownership.

First, mortgage interest and real estate taxes are deductible.

When these write-offs are taken into account, the cost of mortgage payments may be lower than current rent costs. Plus, landlords often raise rents every year, but mortgage payments usually remain stable. Local tax benefits also are available in many areas.

In addition, when you choose to sell your home, you can defer taxes on the profit if you purchase or build another home costing at least as much as the one you've sold within 24 months.

Home ownership also enables you to build equity - the difference between the value of your home and the balance on your mortgage.

When you decide to sell the property, you can collect the equity in cash, or use it to purchase another piece of property. When you pay rent, your landlord builds the equity instead of you.

As a result, a home could be considered an investment. The yield can be higher on home investments than most other investments. Home ownership can provide a source of emergency funding since you can borrow on your home equity in Oklahoma.

You will also be establishing good credit, which will attest to your financial integrity. Future lenders will respect your responsibility and stability as a homeowner and may be more likely to grant your next loan request, whether it's for another home or a business investment.

However, Engstrom advises there are certain factors that could have significant impact on the investment value of your property that you should consider before making a real estate purchase.

First, land appreciation is critical to any real estate decision. You should try to determine the trends in property values in the area where you are buying: Are sale prices of homes in the neighborhood consistently increasingly each year? Are prices stable or have they been falling? You need to know this information before making a decision to buy because land appreciation can make a substantial difference in how much the home will appreciate in the coming years.

Next, you should develop your criteria (a needs-and-wants list) that you can use to evaluate the homes and neighborhoods you see.

You will want to consider the neighborhood, the distance to job and recreation, trends in property values and if applicable, the quality of local school system. Remember, even if you are single and don't have children, when you decide to sell your home, an excellent or poor school system can positively or negatively affect your home's resale value.

Finally, you also should take into consideration the energy efficiency, heating and electrical systems, and other major home features, before buying a particular house, as these factors can also affect the home's long-term value. The style of the home and its amenities are additional worthwhile considerations to analyze before buying.

LOAD-DATE: March 16, 1998

Evidentiary Exhibit Number 192

ASAP

Real Estate Weekly

March 31, 1993

SECTION: Vol. 39 ; No. 33 ; Pg. 1A

LENGTH: 1258 words

HEADLINE: Bertelsmann deal 'Most Ingenious.' Peter R. Friedman Ltd. wins Henry Hart Rice Most Ingenious Deal of the Year Award from Real Estate Board of New York for 1540 Broadway Street sale to German conglomerate

BYLINE: Fitzgerald, Therese

BODY:

The sale of 1540 Broadway to a German-based conglomerate and the leasing of 240,000 square feet to the Internal Revenue Service were selected as the top commercial brokerage deals of 1992 by the Real Estate Board of New York at its Annual Sales Brokers Cocktail Party held last week.

Peter R. Friedman and Jeffrey A. Lichtenberg of Peter R. Friedman, Ltd., the brokers who represented Bertelsmann AG on their 1.1 million-square-foot acquisition from a consortium of 17 lenders, won the coveted Henry Hart Rice Most Ingenious Deal of the Year Award. When the complex negotiations began building was in default and incomplete.

Carol Nelson, Mary Ann Tighe, Edward Goldman, and Maria Morris of Edward S. Gordon Company won the Robert T. Lawrence Award for placing the Internal Revenue Service in 240,000 square feet in the Durst Organization's 1133 Avenue of the Americas for 20 years and creating a "building within a building" for the tenant.

The coveted awards recognize "distinguished achievement in real estate brokerage."

Building in Default

Friedman and Lichtenberg were first charged with helping Bertelsmann decide what to do with two leases in separated buildings. One lease had a favorable rent and an option to renew and was set to expire near the purchase date. The other had an above-market rent and 10 years to go. The company was considering moving a significant number of employees out of the city.

(Coincidentally the deal that won the Robert T. Lawrence award took place in 1133 Avenue of the Americas, one of the buildings in which Bertelsmann housed its divisions.)

After investigating all lease opportunities, the brokers began to explore acquisition possibilities. The 44-story 1540 Broadway, in default and incomplete, was identified as an "appropriate signature" for the company." Total occupancy costs would be lower and the company would own valuable New York real estate.

The negotiation required working with the developer, Bruce Eichner and a consortium of lenders that included 16 Japanese banks and was led by Citibank. The result was a purchase price of $ 119 million and the first prepackaged bankruptcy for a major Manhattan office tower. The brokers also secured Industrial Development Agency concessions worth more than $ 10 million and managed base building modifications and

completion of more than $ 60 million worth 9;f tenant installations that were made in just under five months. Bertelsmann will occupy some 750,000 square feet.

Friedman and Lichtenberg also had to arrange for the other two leases to end at the same time.

In announcing the award, REBNY noted: "The transaction enabled the purchaser to consolidate its New York staff in one building keeping several hundred jobs here, fortified the city's position as a capital of global communications enterprises, and resulted in a major commitment to increase Manhattan office facilities by a foreign investor/user."

In addition to securing a major tenant for the city, Lichtenberg reflected, the building's troubles and the number interested parties added to the deal's significance.

"None of the buildings that really have problems have been able to get anything done," said Lichtenberg.

The deal, he said, enables Bertelsmann to save money through consolidation and, he said, it will cost them less to own than it would to rent.

" and there are some pretty attractive terms out there for rentals," he said.

In effect, Lichtenberg said, after 20 years if the corporation decides to sell the building, they will have operated rent free for all that time.

But, Lichtenberg said, the idea of buying a building was the first thing that had to be sold to the Bertelsmann.

"They refused to look at something that involved equity initially," he said.

'Building within a Building'

When Carol Nelson, Mary Ann Tighe, Edward Goldman and Maria Morris of Edward S. Gordon Company saw the advertisement placed by the General Services Administration for 170,000 square feet in Midtown in a Class-A Building and 7,000 to 10,000 square feet of retail space, they immediately thought of The Durst Organization's 1133 Avenue of the Americas.

But there were two problems: Some floors in the building were the wrong size and the space was leased with tenants.

"At first glance it looked like a deal that couldn't be done," said Nelson, "yet we were able to look at the deal as a perfect fit."

Durst sponsored the brokers in the SFO and agreed to be represented by the team.

To satisfy the tenant's need for larger floors, the brokers devised to break through the walls of the building and expand into three floors in a connecting recording studio. To do this and prevent the Dursts from exceeding their FAR (floor-to-area-ratio), the brokers arranged for one floor of the building to be closed off.

When Bertelsmann began negotiations to buy 1540 Broadway the problem of occupied space was potentially solved, though the government would only proceed when they were assured the deal would close. The brokers had to negotiate incentives for early departure with other tenants.

The building-within-a-building concept was created when the Durst's became concerned that the IRS' presence would overwhelm the building and that the increased security the agency required would make other tenants uncomfortable. Thus, the brokers arranged for the creation of a separate side entrance for the IRS that would lead to a second floor sky lobby.

According to Nelson, the IRS gets a quality location owned and managed by a top-notch company and the Dursts get a triple-A tenant for 20 years.

REBNY in its announcement cited the "'building within a building' strategy conceived by the brokers gave the I.R.S. its own entrance, security clearance point and elevator bank, among other features, while enabling the rest of the property to retain its identity as a Midtown corporate office tower. The agency's presence and the traffic it will draw should also enhance public safety on 42nd Street."

The deal, according to Nelson, took two years of work and 3000 pages of documentation. Dealing with a government agency brought a number of challenges including: Not knowing who your competition was because the GSA would not divulge such information; the discrepancy between the GSA's definition of net usable space and the industry standard for gross rentable space; getting only one chance to submit a rent offer; and being able to guarantee the delivery of the space so the owner could avoid penalties of $ 13,000 per day.

In addition, the air pumped into the space had to be free of asbestos and the building had to be handicapped accessible.

According to Nelson the deal is significant to the brokerage community because it forced her team and firm to use a vast array of skills and disciplines, including management, architecture, engineering, design, zoning, law etc.

"It sort of reinforced the idea that a broker has to do much more than find space," she said.

The panel of judges consisted of James J. Houlihan, partner, Houlihan-Parnes and chair of the Sales Brokers Committee; Vincent Carrega, executive vice president, James Felt Realty Investment Services; John G. Malino, vice president, Loews Corporation; G. Austin Mooney, president, FGH Realty Credit Corporation; and Keith M. Pattiz, partner, Arnold & Porter.

The Henry Hart Rice Award was presented by REBNY Vice Chairperson Aaron Gural. The Robert T. Lawrence Award was given by REBNY President Steven Spinola.

SIC: 6531 Real estate agents and managers ; 6500 REAL ESTATE
IAC-NUMBER: IAC 13782623
IAC-CLASS: Trade & Industry
LOAD-DATE: August 23, 1995

Evidentiary Exhibit Number 193

Buffalo News (New York)
March 29, 1993, Monday, First Edition
SECTION: BUSINESS; Pg. 14
LENGTH: 2107 words

HEADLINE: WHAT HOME BUYERS AND SELLERS SHOULD DO NOW THAT HOUSING MARKET IS IMPROVING

BYLINE: By WALTER L. UPDEGRAVE, Money Magazine

BODY:

Finally! After a three-year slump during which home prices in some cities fell 15 percent or more and selling a house sometimes took eight months to a year -- or more than twice as long as building one -- the housing market is snapping back. Sort of.

The National Association of Realtors reports that sales of previously occupied homes jumped 8.7 percent in 1992 and could increase by another 5.7 percent this year to 3.7 million, the most in nearly 15 years.

An analysis prepared for Money magazine by Regional Financial Associates, an economic forecasting firm in West Chester, Pa., predicts that the median home price nationwide will crawl upward by 0.1 percent a year from 1993 through 1995, after adjusting for inflation averaging 2.8 percent.

Given the slow-go outlook, it's imperative that your decision to buy, sell, improve or borrow against your home be based on a rigorous assessment of the financial realities of today's markets.

In this article, we offer the wisest strategies for home buyers and homeowners, culled from interviews with dozens of real estate agents, housing analysts, financial planners and economists.

First, some good news. Few housing analysts think that President Clinton would risk sabotaging the housing recovery -- and perhaps his chances of re-election -- by tampering with the hallowed mortgage-interest deduction on primary residences.

Nor do the experts believe Clinton's spending programs will be large enough to reignite inflation fears and drive up mortgage rates much.

Now, though, some news that will be either sweet or sour, or somewhere in between, depending on where you live. The hottest price-gaining cities of the '80s have traded places with the basket cases of the previous boom.

In Denver, 40-year-old single mother Deborah Carter recently took advantage of low rates and affordable prices to snag her first home, a $ 76,000 five-bedroom brick tri-level. During the mid-'80s energy recession, prices plunged as much as 30 percent in some neighborhoods in the Mile High City.

Today, Denver ranks as the nation's hottest housing market with 1992 sales up 23 percent over 1991 and home prices projected by Regional Financial Associates to zip along at 6.6 percent this year. The reason: The city added jobs at an estimated 1.1 percent annual rate last year, vs. the United States average of 0.1 percent.

Houston, where home prices had dropped 30 percent from the 1983 peak, is also reviving. Last April, appreciation potential in Houston had been clouded by the 4,500 repossessed single-family homes that were

being peddled by the Resolution Trust Corp., the federal agency disposing of assets of failed thrifts. Today, that inventory has shrunk to 51 houses, and the RTC plans to shut its Houston office in May.

Meanwhile, areas that cruised to huge gains in the '80s, including much of the Northeast, are now languishing at the bottom of the heap. Just ask Kim Whittaker, 35, and Greg Papazian, 29, who are now stuck with a $ 60,000 Boston condo they'd like to sell. Its value has plunged 48 percent since she bought it for $ 115,000 in the heady days of 1986.

Or ask any Southern Californian. The state's severest recession since the 1930s has pounded home prices in Los Angeles by 20 percent or so over the past three years. And the tarnished image of lotusland has led to recent net out-migration in Los Angeles County, the first time since 1979.

Outward-bound Californians are rousing housing markets in many smaller western cities, such as Spokane, where median prices (lately $ 75,300) have chugged along at a 12 percent annual pace for the past three years.

Vacation homes, which have been rocked by price declines of 30 percent or more in the hardest-hit resort areas in recent years, may also see a turnaround.

A growing number of analysts foresee a mini-boom within the next few years as hordes of baby boomers swell the ranks of prime second-home buyers -- people ages 45 to 54 -- by 46 percent over the next decade.

Century 21 South Central States' general manager Dave Jenks is already seeing a 15 percent to 25 percent sales spurt in areas such as the Texas hill country west of Austin, the Ozarks and northeastern Oklahoma as buyers snap up $ 40,000 to $ 120,000 vacation retreats or future retirement homes.

Warning: In the unlikely chance that a revenue-hungry Congress decides to scrap the mortgage-deduction for second homes, values of such properties could fall drastically. Burl East, a real estate analyst at Kemper Securities in Chicago, believes prices in vacation spots could almost instantly drop 25 percent or more.

To help you capitalize on trends in today's markets or avoid costly mistakes if prices are swinging against you, here is what the pros suggest:

What buyers should do now

Run a rent-vs.-buy analysis if you don't own a home.

Now that home prices can easily lag inflation for years at a time, anyone who is thinking of buying a first house must closely examine whether renting would be more economical.

With price gains slower now, you are usually better off renting unless you plan to live in a home at least five years and thus can count on enough appreciation to offset closing costs and broker commissions. Such outlays can easily run 8 percent to 10 percent of the value of a house.

Denise Leish, a partner in Money Plans, a Silver Spring, Md., financial planning firm, offers this buy-vs.-rent rule of thumb: Rent if the monthly tab on a place you now like is 65 percent or less of the monthly mortgage payment -- including property taxes and insurance -- you'd have as the owner of a comparable dwelling.

For an in-depth analysis, you can compare the after-tax costs of owning and renting using a computer software program such as "Buying Your Home" from Home Equity Software of Mountain View, Calif. ($ 49.95; available at computer software stores) or "Buy or Rent" from Real Estate Consultants ($ 29; (800) 289-6773).

Assess the local market closely before you buy.

You need to know not only the current health of your housing market but the potential for appreciation over the next few years.

To do that, check out the area's recent job growth. In general, if the annual growth rate declines by 50 percent or more -- say, for instance, it drops to 1 percent from 2 percent -- home prices will likely stagnate in the coming year or two.

And if the rate turns negative -- that is, the area is losing jobs -- home prices may actually fall. Similarly, if job growth is picking up locally, housing prices will probably do likewise.

You can find job statistics for 282 U.S. metropolitan areas listed in Employment and Earnings, a monthly publication put out by the U.S. Bureau of Labor Statistics, which is available in most large public libraries.

Don't get caught up in the euphoria of a rising market.

Once sales pick up, real estate agents instinctively tend to urge their customers to move quickly. With house prices moving ahead modestly these days, you can safely ignore such high-pressure tactics from agents.

What sellers should do now

Price your house realistically, even if it means taking a loss.

"Your list price should be based on what homes are actually selling for in your area these days, not on what you paid or what you'd like to get," advises David Wluka, president of the Greater Boston Multiple Listing Service.

To determine an appropriate list price, ask your real estate agent for data on recent sales of comparable homes as well as current listings.

If the market is healthy -- house prices are rising steadily and homes are selling within 90 days -- ask for exactly what similar homes have recently fetched. But if prices are soft and houses are languishing on the market for four months or longer, consider listing your home at about 5 percent below other sales prices.

Give your home a cosmetic makeover.

In boom times, a little curb appeal is often enough to make a sale. But in most places today, you've got to do all you can to make your house the belle of the block.

Pouring in from $ 1,000 to $ 3,000 on cosmetic fixes such as a fresh coat of paint and replacing dated appliances or carpets can make your house stand out.

What owners should do now

Look into refinancing your mortgage if you haven't already done so.

Before you refinance, however, be certain that you'll stay in the house long enough to recoup the loan's closing costs from the new, lower monthly payments. If your new mortgage rate would be one percentage point lower than your current one and the closing costs would equal 4 percent of the loan amount, for example, it will take approximately five years for you to break even.

Owners in areas like Los Angeles and Hartford, where house prices have slumped recently, face another possible hitch: not enough equity to refinance. If your home is worth less than you paid for it, most lenders won't let you refinance unless you bring enough cash to the closing to reduce the mortgage.

Improve your home, but don't overspend on it.

A 1992 Roper poll shows that only 39 percent of homeowners are completely satisfied with their abodes. If you're in the other 61 percent, remodeling may enhance your enjoyment of your biggest asset. But remember that the house's resale value probably won't increase by as much as you spend on it. To avoid over-improving, be sure the market value of your house plus the cost of renovating won't exceed the price of the most expensive homes locally by more than 20 percent.

Don't go overboard on your home-equity debt.

A 7.7 percent home-equity credit line can be an ideal way to finance a home renovation or pay for college tuition. But if home prices fall, you could have to dip into savings when you decide to sell your home.

Assume, for example, that you put down 20 percent on a $ 250,000 house and then took out a $ 40,000 home-equity loan. If prices drop by 10 percent, the debt would exceed your home's market value by $ 15,000 -- a shortfall you'd have to make up to close the deal.

GRAPHIC: listed- Where house prices will sink and soar

LOAD-DATE: March 31, 1993

Evidentiary Exhibit Number 194

The Washington Post

February 6, 1993, Saturday, Final Edition

SECTION: REAL ESTATE; PAGE F6

LENGTH: 4037 words

HEADLINE: REAL ESTATE MAILBAG

SERIES: Occasional

BYLINE: Robert J. Bruss, Tribune Media Services Inc.

BODY:

DEAR BOB: About 10 years ago my wife and I bought 19 acres near a rural freeway interchange. It is zoned for a gas station and motel, plus other commercial uses. But someone else built those on a nearby parcel, so we haven't been able to find anyone to build on our land.

We have the land rented to a farmer for pasture, but the rent barely pays the property taxes and we have to make the mortgage payments out of our pockets. In about nine years we will own the land free and clear.

However, my wife and I have decided to get a divorce. Since this land is one of our major assets and neither of us can carry the expenses alone, we have to sell it.

We have had the land listed for sale the last four years with a land broker and aren't optimistic about making a sale. We have tried refinancing, but no bank or S&L will make us a loan for more than 50 percent of value. That's about what we owe on the mortgage to our seller. We have about $ 35,000 equity. What should we do with this land? -- Robert T.

DEAR ROBERT: As you discovered, buying vacant rural land is much easier than selling it. Virtually the only source of financing today for such property is the seller. Now you know why I never recommend land investments.

However, since you already have a mortgage on the property and not much equity in the land, if you want to get the land sold you should offer easy financing, so a buyer can purchase with a low down payment.

If your existing mortgage does not have a due-on-sale clause, you could sell on a wraparound mortgage. That means the buyer pays you payments and you use part of those payments to keep up payments on the underlying existing mortgage.

If the land hasn't sold in four years, something is seriously wrong. Presuming you have it listed with a good real estate agent, talk it over with your agent to determine if there is any hope of a sale. If not, you might wish to deed the property back to the lender and take an abandonment loss on your tax returns. Your tax adviser can provide the details.

DEAR BOB: The woman who owns the house next door talked to my wife about selling her house. They agreed on the price and terms of the mortgage the woman will carry back.

But when we met at the office of the woman's lawyer, he said he didn't think she was getting enough for the house. We pointed out how much repair work the house needs, but he said he wouldn't let the woman sell to us unless we agreed to pay $ 20,000 more.

The next day the woman listed the house for sale with the lawyer's daughter, who is a rookie real estate agent. I am thinking about suing the lawyer for killing our sale. Do you think I have a good case? -- Richard T.

DEAR RICHARD: No. The verbal agreement between your wife and the neighbor is worthless because the statute of frauds requires contracts to sell real estate to be written to be enforceable in court.

The lawyer's job was to advise his client on the legal aspects of the sale, not on the market value of the house. If the contract had been in writing and the lawyer interfered with your sale, then you would have grounds for a lawsuit based on the tort of interference with economic relationships.

However, since the verbal contract was not enforceable, I suggest you forget about a lawsuit. For details, consult your own attorney.

DEAR BOB: When we bought our home about 12 years ago we got an open-end mortgage, which we used once to increase our mortgage balance after the house appreciated in market value a few years later. We paid off that loan several years ago when we refinanced.

Since mortgage interest rates now are so low, we want to refinance again. But we can't find any lender making open-end mortgages. We want one because we plan to remodel in a few years and would like then to increase the mortgage balance without all the costs and hassles of refinancing.

Do you know any lenders currently making open-end mortgage loans? -- Kent E.

DEAR KENT: I haven't seen an open-end mortgage for many years. The reason is that most home loans are on standardized forms, so the loan is easily salable in the secondary mortgage market to nationwide buyers such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corp. (Freddie Mac). I doubt you'll find any residential lenders making open-end mortgage loans today.

DEAR BOB: It took almost a year, but in late 1992 I finally sold my large house that I had inherited from my late husband. Thanks to the wonderful stepped-up basis tax rules for inheritances, I don't owe any tax on the sale. But now my problem is I am not sure whether to buy or rent a home.

Temporarily, I am living with my son and daughter-in-law. They seem to like having me around because I baby-sit for their two little children while they are at work. But frankly, although I am only 72, the children wear me out, so I don't plan to stay here more than a few more months.

My question is, at my age, do you think I should buy or rent? I would like a nice little two-bedroom house. What do you advise? -- Marcie S.

DEAR MARCIE: Your question is often asked. Retirees hesitate to buy a home and tie up their cash, which they might later need for emergencies or investments.

The big risks of renting an apartment or a house are rising rents and having to move if you can't afford the increased rent or if the landlord wants the property for personal use or perhaps to sell. Many retirees don't like these uncertainties, so they elect to buy a house or condominium.

Another alternative is to enter a life-care retirement home. But there also are risks with this choice. Some charge a monthly rental fee, but most have a very high entrance fee that is nonrefundable.

For example, I know a woman about 70 years old who paid $ 64,500 to enter a life-care retirement home and live in a tiny studio apartment. She also had to pay almost $ 2,000 per month for meals and rent. She lived there about a year before dying suddenly of a heart attack. That was a very bad investment for her and her surviving children, who received very little inheritance.

If you decide to buy a small house, I think your best alternative is to buy by making a small 10 percent to 20 percent cash down payment and obtain a mortgage for the balance. Then you won't tie up a large amount of cash that you would if you buy for all cash.

Of course, another choice is to pay all cash for the house, but if you later need money to live on, you could borrow on a reverse annuity mortgage that pays you a monthly amount. However, reverse annuity mortgages are extremely expensive and, while the theory is great, they can be very costly.

DEAR BOB: We made an offer to buy a house that was listed with a reputable nationwide real estate brokerage. The agent presented our offer to the man who signed and accepted it. But the agent informed us that it is a divorce situation and the woman refused to sign.

In the meantime, we went ahead and arranged mortgage financing. Now we are ready to close the sale. What can we do to get the ex-husband and ex-wife to show up at the closing? -- Rupert H.

DEAR RUPERT: The ex-wife is not obligated to agree to the sale because she never accepted your purchase offer. If both ex-husband and ex-wife hold title to the house, they both must sign the deed to convey legal title to you.

At this point, I suggest you leave it up to the real estate agent to put pressure on the ex-husband and ex-wife to either sign the deed or forget about the sale to you. The agent is more motivated than you are -- and is in the best position to get things moving.

However, I recommend that you give the agent a deadline, such as 10 days, otherwise you will cancel the purchase and buy another house. You can be certain the agent will convey that message to the sellers and do everything possible to make the sale close as quickly as possible.

DEAR BOB: My husband died about a year ago, leaving me with a big house where we raised our family. It has five bedrooms and a big mortgage.

Since I live near a college, last fall I advertised rooms for rent. Four wonderful college boys each pay me $ 100 per month rent, so I have no trouble paying the mortgage and utility expenses. I let them have small parties on the weekends in the basement and they even invite me, too.

But now that my 1992 income taxes will soon be due, I'm wondering if I have to report this rent to Uncle Sam? -- Naomi T.

DEAR NAOMI: Yes, Uncle Sam wants you to report your rental income on Schedule E of your federal income tax return. But you also can deduct applicable expenses, such as part of your mortgage interest, property taxes, utilities, insurance and repairs.

In addition, you can depreciate the areas of your home used by your tenants. I highly recommend consulting your tax adviser to be sure you maximize your tax deductions for these rentals.

DEAR BOB: We plan to sell our home soon. Do you think we should list it for sale with a large or small real estate brokerage firm? -- Herman C.

DEAR HERMAN: The size of the real estate brokerage firm is irrelevant. What is important is the quality and success record of the individual realty agent with whom you list your home for sale.

I am a licensed real estate broker, but whenever I sell one of my rental houses I always list it for sale with a local real estate agent. Why? Because a property owner can't be objective about selling his or her property. I find the benefits of hiring another agent far outweigh the sales commission expense.

Over the years I have listed houses with one-person firms, small firms and large firms. I've learned the size of the firm doesn't matter. Yes, the large firms often make "in-house sales" where another agent with the same firm has a buyer. But I don't think that is important.

What is critical is the quality of service and the success record of the real estate agent. You want an agent who will devote time and effort to selling your home. For this reason, you may want to avoid the "top-top agents" who carry more than 10 listings at a time. There is no way such an agent possibly can do a good job.

Hire the best agent to list your home for sale. Interview at least three agents. To find these three agents, ask friends and business associates for recommendations. Also phone agents whose "for sale" signs in your neighborhood have turned into "sold" signs.

Each agent you interview should give you a written comparative market analysis. This form will show you recent nearby sales prices of comparable homes as well as asking prices of neighborhood homes currently for sale -- your competition. It also should show the agent's suggested asking price and probable sales price for your home. When interviewing each agent, be sure to ask about fees, services, client references and anything else you want to know.

But before you list your home for sale, ask each agent for the names and phones of their three most recent sales. Also ask for the names and phones of their three most recent expired listings, if any. Before signing a listing, phone these people to ask: "Were you in any way unhappy with your agent and would you list your home for sale with the same agent again?" You soon will know which agent should get your listing.

Finally, don't sign a listing for longer than 90 days, unless it contains an unconditional cancelation clause, just in case you choose the wrong agent.

DEAR BOB: A few years ago we followed your advice and deferred our profit tax when selling our home and buying a larger one. Now we have to sell the second home, which we bought in 1987.

Since neither of us is yet 55 years old, is there any way we can avoid paying our deferred profit tax again? -- Henry H.

DEAR HENRY: You can use the "rollover residence replacement rule" of Internal Revenue Code 1034 over and over again without limit to defer tax on the sale of your principal residence. However, within 24 months before or after the sale you must buy a replacement principal residence of equal or greater cost to defer the property tax again.

But you cannot use this tax break more frequently than once every 24 months. Since your last home sale and purchase was in 1987, you don't have a problem with using IRC 1034 too frequently. However, this tax deferral can be used more often than once every 24 months if the home sale also involves a job location change that qualifies for the moving expense tax deduction. For details, consult your tax adviser.

DEAR BOB: We had our roof replaced last year. When the roofers took off the old roof, they noticed what appeared to be termite damage. A termite inspection company found damage that cost us almost $ 22,000 to repair. Can we deduct this $ 22,000 expense on our 1992 income tax returns as a casualty loss? -- Michael N.

DEAR MICHAEL: The casualty loss tax deduction is available only for property owners who suffer a "sudden, unexpected and unusual" loss. Examples include fires, floods, hurricanes, earthquakes, accidents and thefts.

But termites work too slowly to qualify for a casualty loss. Only if you could prove your termites worked very, very fast to cause the damage would your loss qualify as a casualty loss. Your tax adviser can give you further details.

DEAR BOB: Our house has been for sale almost six months. Last month we finally got a purchase offer. It was far below our asking price, but we had no sales activity on our home in six months, so we decided to accept.

The buyers have excellent income and credit so we expected them to easily get a mortgage. They applied for a loan at their bank. But the appraiser valued our house at $ 15,000 below the low price they offered us. As a result, they can't get the full mortgage they need.

The realty agent asked them to apply with another lender, but now they are thinking they offered too much for our house. What can we do about this low appraisal that is killing our home sale? -- Doris W.

DEAR DORIS: There is nothing sacred about appraisals. They often are wrong, especially if the appraiser is not very experienced or familiar with the neighborhood.

If your buyers paid for the appraisal, the lender must give them a copy of the appraisal. Ask to see it to determine if the appraiser used truly comparable recent sales prices of similar nearby homes.

If not, your buyers can request a re-appraisal. If you have information on recent nearby home sales prices, be sure to provide the details to the appraiser.

Remember that an appraisal is just an educated guess of a property's probable market value. The best evidence of market value is an actual sale between a willing buyer and a willing seller, neither being under pressure to buy or sell.

I often have requested re-appraisals and supplied recent comparable home sales prices to the negligent appraisers. The appraisal then is usually adjusted to make the property's market value come out right. There are now many brand-new appraisers who just passed their license exams, so it is not surprising your buyer received a low appraisal.

Another alternative would be for you to agree to carry back a second mortgage to fill the finance gap caused by the low appraisal.

DEAR BOB: Please explain exactly how to deed a property to the lender if the market value has fallen below the mortgage balance. -- Bruce K.

DEAR BRUCE: The situation to which you are referring occurs when the mortgage balance exceeds the property value and the borrower is unable to keep up mortgage payments. To avoid a foreclosure, some borrowers mail the keys to the lenders. However, that is not sufficient.

Some lenders will accept a deed in lieu of foreclosure, so the borrower does not get a foreclosure reported on their credit report. But many lenders have a foolish blanket policy of refusing to accept deeds in lieu. They fear getting stuck with junior liens the borrower has incurred. However, if there are no such junior liens against the property, lenders can save thousands of dollars in foreclosure costs by accepting a deed in lieu of foreclosure.

But for borrowers whose uncooperative lenders will not take a deed in lieu of foreclosure, there is a perfectly legal dirty trick that the borrower can play on the lender. Just prepare a quit claim deed to the lender, pay the transfer fees and record it. When a lender receives such a deed in the mail, most lenders will keep it rather than deeding the property back to the borrower.

The happy result for the borrower is avoiding a foreclosure and a possible deficiency debt to the lender. If loan payments were kept current before the borrower deeded the property to the lender, then the lender cannot report any late payments on the borrower's credit report. A local real estate attorney can give you details.

DEAR BOB: We are negotiating with our landlord to buy the house that we have rented for the last two years. She suggested a 24-month lease with an option to buy. Our monthly rent was $ 850, but we have agreed to an increase to $ 1,000 per month if she will give us a $ 400 per month rent credit toward our down payment.

Do you think this is fair to us or should we ask for a bigger rent credit? -- David A.

DEAR DAVID: Congratulations on your successful lease-option negotiation with your landlord. A 40 percent rent credit toward your down payment is excellent.

The general rule is the higher the rent credit percentage, the greater the probability the tenant will exercise the purchase option.

DEAR BOB: My wife and I want to buy a home. But we have poor credit caused by unemployment and illness about two years ago. We tried to pre-qualify for a home loan. So far we have been rejected by four lenders. They all tell us to come back in a few years when our credit report clears up.

However, we don't want to wait to buy a home. We have 20 percent for a down payment, but that doesn't seem to help. Any suggestions? -- Vickie H.

DEAR VICKIE: Yes, there are many ways you can buy a home, even if you have bad credit. One is to buy a home with seller financing. Many sellers, especially elderly people, own their homes free and clear. When you present them with a purchase offer providing for a 20 percent down payment and an 80 percent carry-back mortgage, they will understand for the first time what a great investment that a mortgage can be.

Another alternative is to buy a home with an assumable existing mortgage, such as an older Veterans Administration or Federal Housing Administration home loan. These mortgages usually can be assumed without qualifying. All you have to do is pay the $ 45 transfer fee.

Still another alternative is to borrow from a lender of last resort, such as a finance company. One home buyer with a credit problem such as yours obtained a high interest rate mortgage from a finance company. She plans to keep that loan only a few years until she can refinance when her credit report improves.

DEAR BOB: I own about $ 500,000 of common stocks that have done very well in the last few years. My profit is well over $ 200,000. But I am getting worried about the stock market and would like to sell out.

However, I can't afford to do so because taxes would take at least 28 percent of my profit. I r wonder if I can make a tax-deferred trade of my stocks as down payment on real estate investment property? -- Betsy C.

DEAR BETSY: No. You are proposing a trade of personal property for real property. Unfortunately, such a swap won't qualify for an Internal Revenue Code 1031 tax-deferred exchange. The tax law allows only a "like kind" trade of investment or business real estate for another such property of equal or greater equity and market value. For details, consult your tax adviser. DEAR BOB: We own a summer vacation home. Our lot was zoned so we could build a second house on the property. We planned to do that so our son and daughter-in-law could have a private house when they come to visit us.

But last winter the county downzoned all the properties in our area to allow only one dwelling per lot. It seems the year-round residents railroaded this rezoning through while the summer residents such as us were away. Is this legal? -- Todd C.

DEAR TODD: Presumably you were notified and given an opportunity to appear at the public hearing on the downzoning. If not, you should retain an attorney to object if the rezoning procedure was improper.

But if you were notified of the public hearing and failed to appear, then you have no grounds to object. A governmental agency has no obligation to pay a property owner for reduced value because of downzoning as long as some economic use remains. For details, consult your attorney.

DEAR BOB: My wife and I began talking about refinancing our home loan in January when interest rates came down. But we procrastinated.

In August, we applied for a new loan with a mortgage broker who was recommended by a friend who is a real estate agent. The broker kept asking for more paperwork verifications of our income and bank deposits. Since we weren't buying a house, we couldn't figure out why the lender needed to verify our bank deposits.

When our loan hadn't been approved by early October, I confronted the mortgage broker. He admitted he couldn't place our mortgage with a lender because I am a self-employed manufacturer's representative.

I have been in the same type of work more than 20 years. Naturally, we were very disappointed. I demanded refund of our $ 500 application fee, but the mortgage broker refused. He also refused to refund our appraisal fee, but I did get all the appraisal papers to use with another lender.

Then my wife heard an ad on the radio from another mortgage broker who claimed he could place any loan. So she phoned. The next evening, a very friendly loan agent came to our house to take our loan application. She said we wouldn't need a new appraisal, as the first one was acceptable.

About three days later, she phoned to say our fixed-rate, no-points mortgage had been approved.

Within four weeks, we closed the loan and received enough cash to pay off all our installment loans.

I'd like to know what we did wrong with the first mortgage broker and what we did right with the second one. Our son and his new wife are in the process of buying a home and we don't want them to make the same mistakes we did. -- Ivan R.

DEAR IVAN: Thank you for sharing your valuable experience. As you know, mortgage brokers are middlemen between borrowers and lenders. Despite the recommendation from a realty friend, your first mortgage broker obviously didn't have contacts with enough lenders to place your loan.

Self-employed borrowers often have difficulty obtaining home loans, but since you have been self-employed for more than 20 years with presumably good credit, your loan should not have been difficult to place. The first mortgage broker should have quickly refunded your $ 500 application fee since he failed to do his job. Small Claims Court is the appropriate place to sue for a refund.

The excellent quality of the second mortgage broker shows the big difference in service.

Personal recommendations are usually the best way to find the best mortgage brokers but that method didn't work for you. I surely will hear from mortgage brokers and perhaps they can offer a better method of locating mortgage brokers who can place virtually any home loan with a lender.

DEAR BOB: There is a vacant lot that we want to buy to build our dream home. It is for sale by the owner. I think the asking price is outrageous, but I have no guidelines for making an offer. The lot has been for sale about two years. Any suggestions? -- Herbert W.

DEAR HERBERT: Before making your purchase offer, I recommend you obtain a professional appraisal of the lot's fair market value.

Be sure the appraiser has experience appraising vacant parcels because most appraisers only evaluate single-family houses.

The appraiser will use recent nearby sales of vacant lots and reduce their sales prices to cost per square foot, which then can be applied to your lot. Adjustments must then be made for the pros and cons of the lot.

Readers with questions should write Robert J. Bruss at P.O. Box 280038, San Francisco, Calif. 94128.
LOAD-DATE: October 14, 1993

Evidentiary Exhibit Number 195

The New York Times

November 29, 1992, Sunday, Late Edition - Final

SECTION: Section 10; Page 1; Column 2; Real Estate Desk

LENGTH: 2334 words

HEADLINE: How Brokers Make Do In the Sluggish Market

BYLINE: By MERVYN ROTHSTEIN

BODY:

CHARLES DARWIN called it natural selection. For Herbert Spencer, it was the survival of the fittest. But whatever one terms it, it's what has been happening in recent years to brokers and sales agents as the downturn in the real estate market has both diminished their numbers and required those who have remained to adopt different strategies, or variations of old ones, to stay alive.

Many companies, large and small, have gone out of business; those that remain have cut back dramatically on spending for advertising and promotion. Emphasis has been placed more and more on specialization, on the international market, on relocations and foreclosures, on referrals and on doing everything possible to increase contact with those who might provide them.

The need to share properties in a diminishing marketplace has led to a sharp rise in co-brokering and the increasing influence of the listings broker. The focus is on service.

"When the market was so hot, there was enough business -- in fact, there was an overflow -- there was room for new people to come in and do quite well," said Hall Willkie, senior vice president of Brown, Harris, Stevens in Manhattan. "But as the market contracted, many people dropped out. The situation didn't leave room for anybody who wasn't a seasoned professional, who didn't have the necessary experience combined with a large referral network."

Paul Stehnach, the sales manager of Prudential/Rita Cohen Realty in White Plains, put it this way: "This is no longer the part-time housewife business. These are full-time professionals who work in real estate."

Statistics tell part of the story. The number of licensed brokers and sales people in Connecticut plummeted from 3,765 on July 1, 1986, to 24,654 as of July 15, 1992, according to the National Association of Real Estate License Law Officials. New Jersey also saw a decrease, from 82,000 in July 1986 to 79,901 in June 1992, according to association figures. And in New York, the Department of State reports a decline from 129,234 in July 1986 to 126,839 in October 1992.

ONE of those who fled is Roz Costin of Bedminster, N.J., a sales agent for six years -- the last four of them with Coldwell Banker in Chatham, N.J. -- who now has her own business creating and selling wreaths, baskets, floral arrangements and other items.

"I was just getting frustrated being in the office every day and having nothing come to fruition," Ms. Costin said.

She entered the business in 1984, when the market was thriving, and "made a lot of sales and a lot of money," she said. While she was selling real estate, she began creating wreaths and baskets as closing gifts. In 1990, with the real estate market becalmed, she left. Now she successfully sells her crafts to stores, private customers -- and realtors.

Not only are there fewer people, but there are fewer companies. "It was quite a bloodbath," said Clark Halstead, managing partner of the Halstead Property Company, a Manhattan brokerage. The casualty list in Manhattan alone of brokerages that no longer operate here or were absorbed into other companies includes the huge M.J. Raynes residential branch, Sulzberger-Rolfe, Pogue-Simone, Hahn & Gifford Realty, Cross & Brown Residential, Kenneth Ives, the Rachmani Corporation, Weichert Manhattan, Schlott Realtors, B.J. Gottesman and Lyons & Associates.

Five years ago, a broker would get a listing and advertise in a newspaper in the hope of pulling in a buyer. Today, that same broker more than likely gets a listing and then offers it to every broker around, one of whom eventually brings in the buyer and shares the commission.

Barbara Corcoran, head of the large Corcoran Group in Manhattan, said that the number of co-brokered deals at her company had increased from just under 30 percent in 1988 to 82 percent this year. "All the brokers have learned to share, because everyone is desperate in a recession," Ms. Corcoran said.

As soon as the downturn hit, said Jody LaMonte, a vice president at Corcoran: "I took myself right out of the buyers' market and I put myself into the sellers' market. I stopped looking for buyers and started promoting the product itself. I would collect the brokers and bring them to the product, and outside brokers would find the buyers."

Promotion, Ms. LaMonte said, was the key. "What happened," she said, "was that there was such a collection of inventory that was not being moved. Someone attempting to sell a nine-room apartment was one of a multitude of people with nine-room apartments. But if they gave it to me, I would dress it up and present it with a marketing plan -- color photos, brochures -- and get many brokers in the field actively trying to sell it. And for me, in the end, even if it took time, it still guaranteed that the property would be sold and that I would be a participant in the sale."

Co-brokering, of course, means a lower commission income, already down because prices have fallen about 35 percent in Manhattan over the last four years, according to Ms. Corcoran. The standard 6 percent is shared in a co-brokered deal, with half going to the listings broker and half to the agent who finds the buyer. In addition, about 50 percent of a broker's commission goes to the brokerage concern -- though high-productivity brokers can often keep as much as 65 percent. (Even in today's market, though, a top-flight, experienced residential broker with good contacts can earn $200,000 a year or more.)

Ms. LaMonte said that the reduced commission was compensated for by increased volume. And with the need for higher volume, ech sales person is making more deals.

"In 1988 my top sales people made seven or eight deals a year," Ms. Corcoran said. "Last year, it was 11 or 12 deals. More deals to earn less."

Much more work is required to close those deals, and even to get the business in the first place. Customers are increasingly sophisticated, and there aren't as many of them. Referrals from satisfied customers, always highly important, have become even more so. "I tell my sales people that they have to promote themselves, they have to develop relationships," said Peter Helie, president and chief operating officer of William Pitt Real Estate in Stamford, Conn. "I tell them to get involved in organizations where they can develop those relationships: the United Way, church organizations, clubs, the arts, fund raising for the American Cancer Society. And in addition to business, they can get personal enjoyment out of what doing those things."

Specialization is the key, Mr. Helie and other real estate people say. Two areas of specialization that continue to be important, Mr. Helie said, are relocation and foreclosures. "We have a full-time person who does

nothing but call on businesses to see if he can help with employees," he said. "And we have a full-time person who does nothing but call on banks."

But because of the recession, the relocation business in many areas is not what it once was. "It was a good percentage of my business for a long time," said Rita Cohen, head of Prudential/Rita Cohen Realty in White Plains. "But there's less of it now. Not as many companies are coming into the area because Westchester is considered too expensive. United Parcel Service and J.C. Penney, for instance, moved out and went South."

Evelyn Atanas, owner of Atanas Realty in Williston Park, L.I., said that the relocation business was also down in her area. "Transfers have helped business in hard times," Ms. Atanas said, "but not as many people and businesses are coming to Long Island as used to."

And, Ms. Cohen said, there is danger in foreclosures, because a foreclosed house is almost always sold for much less than what a similar house in the same area usually brings. "Foreclosures can give you business," she said, "but if things aren't handled properly they can hurt values."

Another area of specialization, especially in difficult times, is rentals. "We increased the number of rentals," said Mr. Willkie of Brown, Harris, Stevens. "We set up a rental department and concentrated on it. In the past, we had so many sales we didn't bother with rentals. But these days, some people who are hesitant to buy in this market decide to rent."

Mr. Halstead also started a rental division, which he said now accounts for 10 to 20 percent of his revenues. (He also opened a foreclosure department that he said had brought in new business.)

Yet another area is foreign sales. "There is always a foreign market in New York," said Carrie Chiang, director of international operations and a vice president of the Corcoran Group. But even that market has changed because of the downturn. "There are two types of buyers," Ms. Chiang said, "and five or six years ago you had both kinds of buyers. At the height of the market, some people were buying because they needed to buy for one reason or another. Right now it's people who are business-minded, who buy blocs to rent out to get net income because it's better than the 3-4 percent interest you get for your money in the bank. In New York, if you know the right product you can get 6-7 percent profit."

Franchising is another possibility. Ms. Cohen of Prudential/Rita Cohen said that for her becoming a franchisee was a major way of dealing with the downturn. Many brokers disagree on the value of becoming a franchise of a larger company, but Ms. Cohen said that the positives greatly outweighed the negatives for her.

"I am not a joiner," she said. "But when Prudential contacted me and asked me if I wanted to be a franchisee I realized that there was strength in numbers. I have a smaller firm with the advantages of a larger firm." She said that franchising allowed her to participate in cooperative advertising and to offer many additional services to customers that she could not have provided on her own, including discounts on moving.

High on just about everyone's list of changes was the need to find different and more creative ways of advertising their properties, including direct mail and the use of color photography.

"We looked for new marketing ideas, different ways of finding buyers, different avenues of advertising," said Mr. Willkie of Brown, Harris, Stevens. "We increased contacts with brokers around the country, around the world. We did more display advertising, we designed more brochures."

Alan Rogers, managing director of Douglas Elliman, the giant Manhattan brokerage and management firm, said that his company had become "very aggressive in our marketing."

"Advertising is often the first thing cut," Mr. Rogers said. "But we've increased our advertising every year. What it comes down to is that in a tough market you have to be prepared to advertise in an aggressive fashion, more aggressively than in a boom market. That's what people are looking for -- they want to see their property advertised, exposed in every way possible."

Douglas Elliman, which has expanded substantially in the downturn, largely through the acquisition of Cross & Brown and Sulzberger-Rolfe, twice a year publishes and distributes 50,000 copies of a 32-page glossy magazine called Treasury of Fine Homes, a listing of residences in every price range. It has also recently put out 50,000 copies of a similar color brochure called the Folio of Fine Homes, which includes properties that go for under $500,000.

Sharon E. Baum, vice president and director of exclusive marketing for the Corcoran Group, said she often tailored her advertising to the product. "If we think it's a property that might appeal to someone in the music industry," Ms. Baum said, "we will advertise not in The Wall Street Journal but in the Hollywood Reporter or Variety. And if we think that an apartment near a hospital might appeal to a doctor at that hospital we might try to see if we can get in and post a notice in the doctors' lounge."

Everything -- from finding the buyer to getting a mortgage from a bank -- is just that much harder.

"I'VE never been in a market where buyers were more educated," Ms. Baum said. "They know the impact of maintenance, the ratio of maintenance to purchase price, the cost of a new kitchen or bathroom. They are very savvy. They want to make an intelligent purchase."

And so personal service has become what counts -- in every area. "You have to hold their hand," said Ms. Atanas of Atanas Realty, "take them everywhere, show them what the town has to offer, show them the schools, introduce them to the principals, sit in on the classes, spend a great deal of time with them."

And sometimes real estate people have to take the concept of personal service one step further.

"Not long ago I had an exclusive listing," Ms. Atanas said, "a terrible house in a prime location. The house was in very bad condition. A couple had lived there for maybe 40 years, and I don't think anyone had ever dusted or cleaned it. A nice young couple saw it and immediately said they wanted it. The house was sold as is, and we went to contract.

"The couple applied to two banks for a mortgage. One of the banks sent a brand new appraiser who started hitting the ceiling above her in the basement with a screwdriver. And suddenly the whole kitchen above collapsed. So of course the bank wouldn't give us a mortgage. The only way to get one was to replace the entire floor. And the house also needed new light fixtures, a new garage door and new stoops."

So, Ms. Atanas continued, she and the couple obtained permission from the attorneys and, together with the father of the young man, went to the house one night and started work. "We put up the new garage door," she said. "We repaired the stoops. We put in the light fixtures. We put in the floor. I had never put down a ceramic floor. What do I know from putting down a ceramic floor?"

A few years ago, Ms. Atanas said, none of it would have been necessary. "But we did a great job," she said. "The house is gorgeous. And we got the mortgage."

And she got the sale.

GRAPHIC: Drawings

LOAD-DATE: November 29, 1992

Evidentiary Exhibit Number 196

Chicago Tribune

November 28, 1992, Saturday, NORTH SPORTS FINAL EDITION

SECTION: HOME GUIDE; Pg. 6; ZONE: N

LENGTH: 697 words

HEADLINE: When would-be seller should rent out house

BYLINE: David W. Myers, Cowles Syndicate, Inc

BODY:

The real estate market remains slow in many parts of the country, so many would-be sellers who are anxious to move are willing to rent out their current home. If you're one of these owners, make sure that prospective tenants understand that you're trying to sell the house.

Q - I put my home up for sale two months ago, but have yet to get any offers. My wife and I are closing on our new home next month, so we're thinking about renting our old home out while it remains on the market. Is this a good idea?

A - The answer depends on many variables, including the distance between your old home and your new one, and the type of tenant you could find if you decide to rent your place out.

If the new home that you're buying is far away from the one you want to sell, I'd lean toward selling the old house at a deep discount instead of finding a renter. Most small-time landlords have to make repairs and manage their property by themselves, because they'll lose money if they have to hire professionals or a management firm to do the work for them.

Managing your own property is fine if you know basic repair skills and the property is close by. But it's impractical if your rental property is several hours away from your new residence, or if you don't know how to fix common problems such as clogged toilets or stuffed-up sinks.

If you consider all the advantages and disadvantages of renting your current home and decide that finding a tenant is your best option, tell each prospective renter that you're trying to sell the house and that you'll expect their cooperation when it comes to showing the property.

Although a standard lease agreement requires renters to provide "reasonable access" to the home, you should add an addendum to your rental contract that spells out when the house can be shown to potential buyers. Including such a clause can help prevent confusion after the tenant moves in, as well as provide you with legal ammunition if you must eventually take an uncooperative renter to court.

Q - A friend of mine collects antiques. He is thinking about starting up his own antique business and wants to rent a small shop in a local mini-mall. The landlord has offered him a pretty good deal, but insists on a "triple-net" lease. What type of lease is that?

A - A triple-net lease is one that calls for the tenant to pay all of his store's operating expenses, from utilities and insurance to janitorial services and licensing fees. The landlord in a triple-net lease is generally responsible for only two major items: Monthly mortgage payments to the lender on the property and income taxes he owes on his personal profits.

Newspaper advertisements for properties covered by triple-net leases often include the letters "NNN," shorthand for "net, net, net."

Q - I have been reading a lot of stories lately that talk about the great deals I can get by buying property from the federal RTC. What is the RTC? How do I bid on one of its properties?

A - The RTC is the acronym for the Resolution Trust Corp., a federal agency that Congress created a few years ago to dispose of the assets of failed savings and loans.

About half of the 50,000 properties that the RTC is trying to sell are office complexes, hotels, big apartment buildings or other types of structures that are too expensive for most small investors. The bulk of the other half are houses or condominiums in economically depressed areas where the prospects for future appreciation are dim.

True, the RTC offers a few bargains, but you'll have to work hard to find them. Start your quest by writing for the agency's free booklet, "How to Buy Property from the Resolution Trust Corp." You can get the pamphlet by sending a postcard to the RTC Public Reading Room, 901 17th St. NW, Washington, D.C., 20434.

Want to pay your home loan off years ahead of schedule and save tens of thousands in finance charges in the process? Our booklet, "Free and Clear: Getting the Mortgage Monkey off Your Back" can show you the easy way to do it. Send $2 and a long, self-addressed, stamped envelope to David Myers, P.O. Box 2960, Culver City, Calif., 90231-2960.

LOAD-DATE: 12-01-92

Evidentiary Exhibit Number 197

Chicago Tribune

September 25, 1992, Friday, NORTH SPORTS FINAL EDITION

Correction Appended

SECTION: YOUR PLACE; Pg. 21; ZONE: C

LENGTH: 1852 words

HEADLINE: Renter's choice

Turning a condo conversion to your advantage

BYLINE: By Charles Kouri

BODY:

There may never be a better time to be caught in a conversion. If you're in an apartment that is turning into a condominium, the combination of low interest rates and a slow condo market means that renters have some attractive options to consider.

You can stay, and possibly negotiate a more flexible lease or lock in a rental rate until the unit sells. You can buy the unit, and take advantage of a commonly offered tenant discount. Or you can simply wait until the end of the lease, and assess the opportunities at that point.

Of course, there is a down side, but let's explore the good side first. According to the Illinois Condominium Act, tenants must receive a written notice, 120 days in advance, that a conversion is being planned. (Tenants 65 years old and older must have 180 days' notice.) All current leases must also be honored.

So, if you receive a conversion notice and your lease doesn't expire for another year, your lease is still valid and it also may be a valuable bargaining chip. If the building's owner believes he can sell the unit, he may be willing to pay you a sum of money to terminate your lease or may provide financial incentives to move early if the unit is sold. For example, he may be willing to rebate one or two months' rent to you when the unit is sold if you are willing to vacate in a very short period.

The buyout may amount to a few hundred dollars or a few thousand. As one developer explained it, "If a lease is standing between a property owner and the chance to sell a unit for $100,000 or $200,000, they may be willing to make a generous offer for the right to terminate that lease."

If you choose to stay

If your lease is due to expire within the 120-day period of the conversion notice, the owners may choose not to offer you a renewal. Or, they may offer a lease that includes a clause authorizing cancellation if the unit is sold. The clause will specify how many days the owner must give the tenant to vacate the apartment - typically 30, 60 or 90 days, according to Gary Benson, a Chicago attorney specializing in real estate law. A less formal arrangement is to offer tenants month-to-month leases.

"For someone who is willing to be flexible, it can work out well because an owner usually wants someone in the apartment until it's sold and may offer an attractive monthly rate, or at lease forgo any rent increases," Benson says. Tenants can also consider making the cancellation clause mutual, giving them the right to also terminate the lease for any reason with a 30- or 60-day notice.

"I always tell people to assume the worst-case scenario," says Yehuda Cohen, president of Amquest Leasing and Sales in Chicago. "It could work out that you can stay in the apartment as long as you want without

any problems. But you have to be prepared that the unit could sell any day. You can't tell and the uncertainty may become unsettling. So, tenants may want to leave themselves a way out by having their own cancellation clause."

The right to buy

Another provision of the Condominium Act provides tenants with the right to buy their unit when it goes on the market. As part of the initial notification, the owner must provide a selling price and give the tenant 45 days to respond.

"I think it's probably the best time in history for the tenant to be going through a conversion," says Rosemary Wert, who manages 12 condo properties as director of condominium management for PM Realty, a division of Chicago-based Jupiter Realty, and has been involved in a number of conversions. "Given the current market and the mortgage rates, it's very possible for a tenant to be offered a situation where the mortgage payment is less than their rent."

Jules Marling, president of Marling Marketing Group, sees the same opportunity for tenants. "When you consider the tax incentives of ownership, then the monthly payments are certainly very comparable."

At 345 W. Fullerton Pkwy., a building that Marling is marketing, rents on a two-bedroom apartment ranged from $1,200 to $1,400 per month.

If bought, however, mortgage payments are advertised to be around $1,335. That is calculated on a $175,000 purchase price, with 5 percent down and a 30-year adjustable mortgage with an interest rate of 5.85 percent for the first year. Add to that private mortgage insurance, a monthly assessment and taxes and the actual monthly payment is $1,725. However, when you calculate in the tax savings available from homeownership, which can be more than $4,000 per year, then the effective rate is more in line with the rental rate.

In comparing rental versus ownership, Marling says tenants should also consider the proposed improvements to the building and the value of living in a nicer place. At 345 Fullerton, for example, conversion has meant remodeled kitchens and baths, new carpeting, an upgraded electrical system in the building and a remodeled lobby.

Buying incentives

"Another incentive that makes buying so attractive is a tenant discount, which can be up to 20 percent of the selling price," says Wert. "By selling to a tenant, the owner saves the commission fees and also any marketing costs, and they usually are willing to pass those savings along in the form of a discount."

For Carlos Segura and his wife, Sun, the discount meant all the difference. "If we weren't living here when the conversion was announced, we couldn't be able to afford it. The discount was over $20,000," he says. In August, they made their first mortgage payment on a 1,300-square-foot loft at 540 N. Lake Shore Drive, the same home they have been paying rent on for years. In addition to the discount, the management company provided the Seguras with a list of lenders willing to finance the purchase, and the couple ended up working with one of them.

There have been a number of improvements to 540 since the conversion was announced. "They've installed a health club, a rooftop sundeck, and put in new carpeting and lighting in the hallways," Segura says.

At Valley Lo Towers in Glencoe, residents were also offered a discount and a package of amenities in a purchase package. "The tenant discount was 10 percent and if they chose not to take the improvements to their unit, they could save an additional $9,000," says Andy Warner, vice president of Equity Marketing Services, which is marketing Valley Lo.

John Kretchmar, who is managing the conversion at 540 Lake Shore Drive, as vice president of Habitat Co., estimates that a third of the 150 apartments were purchased by renters. That leaves about 100 apartments covered under a variety of rental agreements or empty - but all available for sale. Even if a tenant chooses not to purchase his or her unit within 45 days, the tenant retains the right of first refusal for up to 90 days. That means that if the owner receives an offer to buy the unit, the tenant has the right to match it.

If any of the options of a conversion are not clear, Amquest's Cohen recommends the renter consult a real estate attorney.

In October, the lease expires on Paula Harter's townhome at Knollwood Townhomes in Palatine, and she is still undecided about what she will do. With the development being converted, she knows she will eventually have to move, but in the meantime, she is considering her options.

"I decided not to buy it. I owned a home before and if I were to buy again, I would want something a little larger," she explains. "(The management has) been extremely flexible. I have the option of getting a six-month lease, a one-year lease or going month-to-month." A six-month or one-year lease would include a 120-day cancellation clause.

Harter also doesn't expect to be continually inconvenienced by interested buyers. "There is a model that is an exact duplicate of this townhome, so they can see the model, and if they are specifically interested in my unit, then they will come by here. I would expect it would be a lot worse if the unit were being re-rented."

The downside

Conversions are not altogether painless or rewarding. Whether the tenant decides to stay, to buy or to leave, there are a number of decisions to be made. For Kris Bartyzel, who also had an apartment at 540, the conversion announcement forced her to consider all her options. She initially pursued buying her apartment, but eventually decided to move into a larger apartment in the same neighborhood.

"The management company handled the conversion in a fair manner and they were available to answer any questions I had," she explains. "I determined that I couldn't afford to buy the size of unit I wanted and there's no guarantee that an adjoining unit would be available if I eventually wanted to expand, so I decided to continue renting and found another building."

As Bartyzel also discovered in assessing her situation, the lending companies would approve a loan but not close the deal until a certain percentage of units sold in the building. At 540, it was one third of the units. That left a certain amount of uncertainty as to when, exactly, rent payments would end and mortgage payments begin.

Segura, who decided to purchase his unit within a few days of receiving notice, had to wait three months before the required number of units sold and the deal went through. However, he welcomed the delay. "It gave us more time to save money," he explained.

Another possible negative is that buildings can quickly turn into construction zones, so having the right to stay in a building until the lease expires may not turn out to be all that terrific. Leases negotiated after the conversion is announced may also include clauses allowing the owner to show the apartment to prospective buyers. Even with a 24-hour or 48-hour notice, the parade of strangers through the apartment may become a nuisance. But here again, being flexible may have its rewards.

Teresa Mason, an owner of CitiSearch, an apartment-finding company, says that it is not uncommon for the building owner to provide the tenant with a rent rebate after a sale, to compensate for the inconveniences. But there's no guarantee an apartment will sell before your lease expires.

Change in atmosphere

Another drawback is that tenants no longer take top priority. Mason says she would make clients aware that management has a greater incentive to accommodate the new unit owners than the current tenants. "I have never heard of any horror stories involving renters dealing with management; it's simply that the atmosphere may be different than in an all-rental building," she says.

Despite the obvious concern, Mason says, "I wouldn't hesitate to place someone in a building being converted, as long as they are aware of the situation. Especially for people who are unfamiliar with the area, such as people transferring from another city, this is a chance to become familiar with the city and see if they really like the apartment before they buy."

So, if you receive a certified letter announcing that your apartment is soon to be on the market, it may just open the door to some interesting opportunities.

CORRECTION-DATE: September 26, 1992

CORRECTION:

Corrections and clarifications.

A story on condominium conversions in the Sept. 25 Your Place section stated incorrectly that the Valley Lo apartments are in Glencoe. They are in Glenview. The Tribune regrets the error.

GRAPHIC: PHOTO: Paula Harter talks with neighbor Don Hagenow outside her home at Knollwood Townhomes in Palatine. The development is going condo, but Harter doesn't plan to buy. Tribune photo by Michael Meinhardt.

PHOTO: A tenant discount induced Sun and Carlos Segura to buy their Lake Shore Drive apartment when it went condo. Tribune photo by Chris Walker.

LOAD-DATE: 09-30-92

Evidentiary Exhibit Number 198

Orlando Sentinel (Florida)
June 7, 1992 Sunday, 3 STAR

SECTION: HOMES; Pg. J1
LENGTH: 1115 words

HEADLINE: 'FOR SALE' BECOMES 'FOR RENT';
IN A SLUGGISH MARKET, SOME HOMEOWNERS RESORT TO RENTING OUT THEIR HOUSES ;
INSTEAD OF LETTING THEM SIT VACANT, WAITING FOR A BUYER.
BYLINE: By Joe Kilsheimer, Of The Sentinel Staff
BODY:

Mike and Valerie Williams moved from Apopka to Colorado Springs, Colo., in January, but they left one big thing behind: their house.

With the real estate market in a slump, it didn't seem to be the right time to put their 2-year-old house on the market. The couple also wanted to leave open the possibility that they might return to Central Florida, where they lived for 16 years before moving.

So shortly after leaving, they leased their house to an executive who liked the layout and location of their 3,000-square-foot residence but did not want to buy it. The monthly rent on the two-year lease is slightly less than their monthly mortgage payment, and the couple is making up the difference out of their income.

"It's not the most ideal situation, but I think it's going to work out OK," said Mike Williams, 40, an electrical engineer whose employer is covering the costs of a temporary rental home as part of his relocation package.

"Right now, we're just about breaking even on the deal. On top of that, we're getting some pretty good tax breaks. And this gives us time to look around up here to see what our best move might be," Williams said.

Whether by choice or by default, some homeowners become landlords when they have to relocate. They can't sell their house, and they find that it's too expensive to let the house sit vacant. There's also a risk of vandalism.

For some homeowners, like the Williamses, the answer is to lease the house until the market improves or until a real estate agent brings a buyer. One advantage is that the rental income can cover all or part of the mortgage payment, which softens the financial blow.

Income tax advantages can be significant. Even if you buy another house, you still can deduct the mortgage interest on your rented house and also take a depreciation deduction. In addition, you can deduct all the business expenses associated with leasing the house, such as lawn care or repairs. If you hire a property manager to oversee the property in your absence, those costs can be deducted too. A property manager's monthly fees depend on the amount of the rent being charged; the higher the rent, the lower the percentage.

The chief disadvantage to leasing is that without freeing up the equity in their old house, many people can't afford to buy a new house. And then there is the worry of living away from your investment. So many things could go wrong: The tenants might stop paying rent; they might trash the place; or there could be a fire.

Real estate professionals say, however, that such risks can be managed. Having the right attitude helps. "The first thing that you have to remember if you are going to rent your house it that it ceases to become your home," said Mark Wade, property manager for G.C. Warner Real Estate in Orlando.

"You have to treat your house now as a business. And all of your fond memories of your house as your home have to go out the window."

Roger Phillips, president of Attwood-Phillips Property Management in Winter Park, said people who decide to lease their house are making a wise decision - if they can afford it.

"I think this is not a desperation move at all. It may not be the best-of-all-worlds kind of move, but I find that people who really must sell their houses when they move do the things it takes to sell, such as dropping the price low enough," said Phillips.

"The people who decide to lease their house usually are people who can afford to do it."

Phillips and Wade, of course, recommend that prospective landlords seek out property managers to look after their houses, especially if they are relocating out of state. Despite their vested interests, they offer solid reasons for hiring a property manager.

"A lot of people will tell me that they're going to get a relative to look after their house. That's all right if everything goes well, but if Murphy's Law takes effect and something does go wrong, who are you going to blame - your relative," Phillips said. "When you lease a house, especially if you plan to be a long distance away, you need a dispassionate third party working on your behalf who has no emotional ties to the property."

Phillips also pointed out that professional property managers usually maintain a network of repair professionals who charge a fair fee for reliable work.

"We manage more than 700 individual houses, so naturally we're going to have a number of roof repairs to do every year, dishwasher repairs, get painting done. We deal with all of our repair services on a bulk basis," Phillips said. "If you as an individual call a repair service from out of town, they know that they're probably never going to hear from you again. Whereas if I call them, they know they better do a good job and charge me a fair price."

Wade also noted that federal tax laws allow deductions for the expenses of hiring and employing a property manager. However, if you manage a property by yourself, you can't deduct the cost of the time you spend with the property.

Regardless of who manages the property, however, there are a a few things homeowners must do if they plan to rent their house.

"Paint the walls, and paint them white," Wade said. "You might love that lovely shade of lavender that goes with your furniture, but someone is going to have different furniture and just won't be as fond of lavender as you are."

If you plan to lease your house on your own, you'll have to do the legwork necessary to find a tenant. That usually involves placing ads in local newspapers and real estate publications or erecting a For Rent sign in your front lawn.

Once you have lined up a prospective tenant, you should check out the applicant's rental history by calling former landlords. You also can check out the applicant's credit history, but you'll need written and notarized permission from the applicant. A credit report from Equifax, a national credit reporting service, costs $8.

If you choose to hire a property manager, you will be charged a leasing fee for the effort to find a tenant. The fee is usually a percentage - 10 percent to 15 percent - of the first month's rent. Once your house is leased, it is still possible to keep it on the market for sale, Wade said. All that is required is that you be honest with the prospective tenant.

"If you actually lease the house, it's probably wise to take it off the market for a little while, just to let the market improve," Wade said. "But you can sign a 12-month lease with the tenant with the understanding that at the end of nine months, the house is going back on the market.

"As long as all parties know what they're getting into . . ., everything usually works out fine."
GRAPHIC: DRAWING c: (Man tied to house) BILL WITSBERGER/SENTINEL
LOAD-DATE: May 16, 1993

Evidentiary Exhibit Number 199

The New York Times

May 31, 1992, Sunday, Late Edition - Final

SECTION: Section 10; Page 1; Column 2; Real Estate Desk

LENGTH: 1974 words

HEADLINE: For the 90's, a New Breed of Housesitter

BYLINE: By NICK RAVO

BODY:

LIKE many people these days, Michele Pharao has been having trouble selling her home, a small one-bedroom condominium she outgrew in Bridgeport, Conn. But instead of selling at a loss or continuing to live in the too-small condo, she chose a lesser-known option: She rented out the condominium and, taking her furniture with her, moved into a house in Fairfield as a housesitter.

"Where I'm living now is more spacious, and I'm saving money," she said.

Ms. Pharao, a 29-year-old electrical engineer who works for the TranSwitch Corporation in Shelton, has her housesitting arrangement thanks, in large part, to today's highly competitive real estate market, which gives sellers whose homes are furnished and occupied an important esthetic -- and hence marketing -- advantage over those offering empty houses.

The arrangement has the additional advantage of freeing sellers, who might otherwise be stuck, to move on and still be able to get their houses back for a buyer on short notice.

The new breed of housesitters has little in common with those of days past. Rather than living rent-free, they pay a small monthly fee to a residential management service. And instead of watching over a bucolic estate for an entire season, they often live for a short time in a suburban home left vacant by a foreclosure, corporate relocation or the sluggish pace of home sales.

Moreover, these housesitters are not live-in caretakers or neighborhood handymen, who water plants, tend pets, patch leaks and perform other chores in return for free housing. Most rarely do anything other than routine housecleaning, lawnmowing and showing the house to prospective buyers.

They also often have backgrounds that are surprisingly similar to the owners of the homes they occupy. Some are transplanted executives. Others are at loose ends after a divorce or a lost job. And some, like Ms. Pharao, are impatient or stranded home sellers.

"Real housesitters are almost nonexistent nowadays," said Jorie Fetty, an agent with Sea Realty in Southhampton, L.I. "I think the reason is that people can get renters and caretakers."

To be sure, there are -- particularly on the East End of Long Island, in upstate New York and in Litchfield and Fairfield Counties in Connecticut -- small subcultures of traditional housesitters who advertise in local newspapers in rural areas or are hired by word-of-mouth. For the most part, though, they are seldom employed for more than a few weeks at a time -- generally, when the homeowners take a vacation. The arrangements, usually, are informal and the housesitters are often longtime friends or relatives of the homeowners. In many cases, they are unmarried young adults who live at home or have just started out on their own.

Madeline Falk of New Milford, Conn., for example, is a single artist and a teacher who has been working on and off as a housesitter or live-in caretaker in Litchfield County for several years, but seldom for more than two or three weeks at a stretch.

"It is nice because every place I go to is gorgeous," she said.

Ms. Falk, who is 28, is currently working as a live-in caretaker on a large colonial estate in nearby Warren, Conn. She also takes care of pets and, if asked, does other chores. She charges from $25 a week to $70 a day, depending on what the job requires. She lives at home with her parents when not housesitting or caretaking. "It is sort of a stop-gap and kind of like living out of a suitcase," she said. "I don't know of anyone who does this professionally."

Carolyn Conto, a 27-year-old teacher, moonlights as a live-in caretaker, charging from $25 a day to $300 a week. She said the longest she has ever worked as a caretaker was six months. And when an owner returns, she moves into a house owned by friends where she rents a room.

"There are people that do this around here," said Ms. Conto, who most recently worked for a week as a live-in caretaker in Washington Depot, Conn. "But not many."

INDEED, old-fashioned housesitters and live-in caretakers may be outnumbered these days by those employed by residential management services. These services -- Home Marketing Associates of Fairfield, Conn., Showhomes of America in Dallas and Caretakers of America in Denver, among them -- constitute a relatively new concept that started in the mid-1980's in part because of the increasingly long time it took to sell a home in many parts of the country.

The services charge housesitters -- who are officially called residential managers -- a monthly fee that, in the New York suburbs, generally ranges from $450 to $1,000, depending on the listing price of the house. The managers also must furnish the entire house and pay for utilities, maintenance and a limited liability insurance policy to cover accidents or neglect. Furthermore, they must make the home available for showing 12 hours a day, seven days a week, and be able to vacate on five days' notice.

Home Marketing Associates, a year-old company, currently has about 30 residential managers living in homes in Fairfield County, Conn., and Westchester County, N.Y. Showhomes of America, which is six years old, has about 70 managers in Connecticut, Westchester County, Long Island and New Jersey. The service is not available in New York City, largely because of co-op board and sublease restrictions.

Joanne Paone, marketing director for Home Marketing Associates, said that some of her managers have lost their own homes in foreclosures but still have a houseful of furniture and want to keep up the appearance of an upper-middle-class life style while conserving cash. Others, she said, are relocated corporate executives, who, usually because it costs less, would rather housesit than rent while they search for a home to buy, decide whether they want to live in a particular town or wait for a move-in date.

"Fairfield County is a very, very active area," said Ms. Paone, who cited the county's large number of out-of-work executives and the steady stream of corporate relocations to and from the area. "We have a doctor in one of our places who moved here from the Midwest, and he has sticker shock."

The primary benefits for a residential manager are the flexibility of not being locked into a year-long lease and the reduced cost. For example, Ms. Pharao pays $450 a month to live in a three-bedroom Cape Cod. Since she collects $600 a month in rent for her condominium, which has an $850-a-month mortgage, she is paying $150 a month less in housing costs because of the housesitting.

The major drawback, though, is the specter of having to move with little notice although, if a home is sold, the five-day period is usually extended by a few weeks. Companies usually try to place their managers in a new home immediately. Even so, for Home Marketing Associates, the average stay in a home is 47 days. For Showhomes of America it is four to six months.

Ms. Pharao has had an unusually peripatetic existence. She has lived for a month in her current home in Fairfield, Conn. She had lived for three and a half months in Darien, two months in New Canaan, two months in Trumbull and five months in Westport.

Each time she switched she had to pay to have her furniture moved, which costs about $200 a move; she does her own packing. The furniture must also fill every room and match the style of the home.

"It isn't a problem for me because I have a lot of furniture, and it pretty much matches with everything," Ms. Pharao said.

Ms. Paone added that the burden of frequently moving several rooms of furniture was mitigated by the sense of home that familiar furnishings can create, particularly if children are involved. "If the child is sleeping in the same bed, they feel less uprooted," she said.

Nevertheless, the life of a residential manager can be unsettling.

"That kind of scared us at first, but we also fell in love with the property," said Jim Benti, who three months ago sold his home in Southbury, Conn., and, as a manager, moved into a four-bedroom, 4,000-square-foot estate on 23 acres in Ridgefield, Conn., that is listed for sale at $1.25 million.

Mr. Benti, 55, is a former sales manager whose company recently went out of business. "We wanted to get liquid and aren't sure if we want to move south or not," he said. "We're sort of in a holding pattern."

He pays $1,000 a month to Home Marketing Associates to live in the main house on the estate, which also has a carriage house, an ice house that has been turned into a studio, a river running through the back yard and a field planted with flowers, corn and vegetables. "We almost rented a place in Danbury for $1,500 that's not as nice," he added. "So, we're saving at least $500 a month."

The chief benefit for the homeowner, who pays nothing for the service, is that a home generally will sell faster if it is furnished and occupied. Insurance premiums are also lower for occupied houses.

"I was skeptical at first," said Judith F. Polgar, who recently had a manager from Home Marketing living in her home in Darien, Conn. "I didn't know what the legal complications would be. God forbid, someone doesn't want to move out."

MS. PAONE said that, legally, the company or the homeowner can take possession of the home any time because there is no lease. Instead, the manager signs a contract that does not grant the rights of a tenant. "Fortunately, we haven't had any problems with anything like that," she said.

Ms. Polgar, whose home sold 12 days after a manager moved in, said the practice was an ideal short-term solution. "We knew the house would sell quickly, so it didn't make much sense for us to get a tenant in there for a year," she said. "Long-term, I'm not sure if I would recommend it."

Residential management services like Home Marketing Associates were born in the Northwest in the late 1970's and caught on in earnest in the oil bust of the 1980's in Texas. They usually find managers through newspaper ads and carefully screen the applicants. They are not, however, put off by recent credit or money problems since many prospective candidates consider housesitting only after they suffer a financial setback.

The services are promoted by real estate brokers, who also pay nothing for the service and are often used by corporate relocation companies, such as PHH Home Equity, and banks that are trying to sell foreclosed properties.

"We are much better off trying to sell a property than renting it," said Dorthea E. Brennan, a first vice president at People's Bank in Bridgeport, which in the last year has used Home Marketing to help sell six homes that have been foreclosed on. "And using Home Marketing accelerates the sales process."

"We're thinking about trying it with condominiums now instead of just high-end properties," she added.

Besides residential management services there are other businesses that supply housesitters for a small daily fee. One of the newest is the National Association of Housesitting Seniors, which employs old people and has affiliates throughout most of the nation, but not in the New York metropolitan region.

There are also services that have caretakers stop by and make security and maintenance checks on homes but not stay overnight. "It is a good job for someone who is retired and not tied up all the time," said Harry Corbin, a caretaker in Southhampton, who has been making regular checks of three local estates since 1986, charging $100 a month and $15 an hour for any maintenance work that needs to be done.

"It is a good service, people want it," said Lois King, the owner of Barclay & King, a real estate agency in Southhampton. "A lot of people who have homes here live in New York City, and the caretaker calls and says you have a leaky faucet, and they call the plumber and turn off the alarm and all the owner gets is a bill."
GRAPHIC: Photos: Michele Pharao, above (Gale Zucker for The New York Times), became a housesitter in Fairfield, Conn., when she had trouble selling her condominium. Harry Corbin, left, is a caretaker for three estates in Southhampton, L.I. (Rameshwar Das for The New York Times)
LOAD-DATE: May 31, 1992

Evidentiary Exhibit Number 200

Chicago Tribune

January 3, 1992, Friday, NORTH SPORTS FINAL EDITION

SECTION: YOUR PLACE; Pg. 3; ZONE: C

LENGTH: 1745 words

HEADLINE: Cheaper by the dozen

12 strategies to make your housing dollar go farther

BYLINE: By Barbara B. Buchholz

BODY:

In spite of President Bush's patriotic admonition to "spend, spend, spend" to get the economy rolling, nervous consumers are making New Year's resolutions to cut purchasing along with pounds.

To most people, not dining out as frequently may seem easier than trimming housing costs, yet there are ways you can make your housing dollar go farther without making too many drastic changes. For example, you can move to a lower-tax area or a lower-maintenance house or simply refinance your mortgage.

Also, if you're thinking of becoming an owner but are short of cash, there are steps you can take so you're still able to buy into the American dream, but at a lower cost. "A home is still a lot of people's last bastion of security and freedom, which they're not willing to sacrifice," says Re/Max real estate agent Susan Wyle Schreiber of the Diamond/Schreiber Group in Highland Park.

Following are a dozen feasible and fairly painless ideas for squeezing the most out of your housing dollar. Which ones you heed should depend on your specific short- and long-term economic and lifestyle goals.

1. Don't spend all you can when you buy and definitely don't stretch. It used to be common to plunk down every penny you had and even starve yourself in order to buy the best - and most expensive - house you could. But conventional wisdom now suggests that it may be wiser to buy a nice house, even a very nice house, but not put your entire nest egg into real estate.

Housing values are not increasing as rapidly as they did when double-digit inflation ran rampant and propelled them. The glitz of the '80s also is passe, and it doesn't pay to look wealthy if you're pushed to your financial limits. In the cautious '90s, people will like you more for your personality than for your address.

Agent Mary-Rita Carey of Koenig & Strey's Chicago office recently had clients who switched from a 2,600-square-foot condominium in a six-flat to a high-rise condo half the size. What they got for roughly the same price were more amenities: a doorman, pool and parking. "They could have qualified for more house, but they were adamant about keeping expenses down in the future and putting more money in the bank," she says.

2. If you own a home, stay put rather than trade up. Historically, homeowners have bought larger and more expensive homes as they climbed the job and social ladders. But in doing so they also have increased their maintenance, furnishing, insurance and property tax bills.

While many affluent homeowners still follow this upward trend, others now resist, says Michael Carliner, an economist with the National Association of Home Builders in Washington, D.C.

If you stay put, but feel the urge for some changes, consider some remodeling or redecorating, both of which are cheaper than moving and paying a Realtor's commission, moving company, attorney, title company and others who reap rewards from the sale of the house.

3. Relocate to a smaller space and use your new quarters more efficiently. The larger the house, the more that people and possessions expand to fill it. The flip side is that many people can do as well with less square footage, which also usually translates into lower purchase and maintenance costs.

Cari Myers found that to be the case when she moved to a split-level in Highland Park from a much larger and older Victorian, after a divorce and as her wholesale sock designing business declined. The new house gave the illusion of space because of new windows and a new kitchen. It also had the benefits of being in better condition and having a smaller yard to take care of. "I lost one bedroom and a formal dining room, but I gained a family room, which really was more important with three children. Our new house is quite cozy and homey," she says.

4. Trim overhead and taxes. Relocate to a less costly home and you can often cut several expenses as well: maintenance, inside and outside; insurance; taxes; and decorating. Plus, you'll gain a lot more time. When interior designer Barbara Strauss Cowan moved to a condo half the size of her Highland Park home after her husband's death, she cut her property taxes in half. She also no longer has to worry about landscaping. Cowan carefully shopped for the right condo and found one nearby with 9-foot ceilings and lots of glass. The building also has an indoor swimming pool and an exercise room. When she remarries soon, she and her new husband will be staying in the smaller setting.

Even if you're not ready for a smaller house, a move to a less costly neighborhood or suburb, especially one nearby, might still help you shave property taxes. Yet, Reed Mitchell Hagee of ERA Mitchell Bros. real estate company in Evanston cautions homeowners that moving because of taxes could hold one unpleasant future surprise: a new community may soon go through a reassessment, and you could end up paying higher taxes in the end.

5. Bank your accumulated equity and rent. Though it's not ideal for everyone, renting can be an option for retired people or families who want to scale down to an apartment temporarily to get back on their feet. This route won't provide deductions on mortgage interest, real estate taxes or loan points, but it will allow you to put some money in the bank and gain a sense of security, which to some people may be worth a lot more, says accountant Randy Abeles of McGladrey & Pullen in Chicago. And, if your income goes down, as in the case of many retirees, there also are not as many tax advantages in owning.

One Lake Forest couple has found renting a good choice for several reasons. The maintenance on their 6,000-square-foot-plus home with greenhouse and potting shed was costly and time-consuming. They also didn't want to worry about selling if the husband, who recently lost his job, found a new position out of town.

So they rented a smaller house nearby that was in good condition and, in the process, have found they like the freedom of renting, which they say is akin to being on a prolonged vacation. They also like living in smaller quarters. Paying a whopping capital gains tax on the house they sold is not a concern because they believe they'll buy within the two-year period the Internal Revenue Service gives them to roll their profit into another home.

6. If you do move, decorate or remodel inexpensively or in stages. Few houses or apartments are really in move-in condition when you buy them - no matter what you may think initially - and downsizing will likely require some changes to personalize the space. Costs can be kept down by working on the overall effect rather than the individual pieces or by tackling the job in stages to spread out the cost.

Homeowner Kathy Rice took the former route with the help of her interior designer, Cathy Kominsky. Among Kominsky's suggestions were to use a few splashes of expensive material such as marble rather than

acres and to change hardware for an inexpensive, fresh look. In other cases, Kominsky suggests choosing a monochromatic color scheme to make small rooms appear larger; selecting durable carpets and wallcoverings and stain-resistant fabrics to trim maintenance time and money; and choosing pleated shades and mini-blinds over more expensive draperies.

7. Take in a boarder to defray costs or help pare maintenance. This is a good tactic if you've got a big old house with a third floor or servants' quarters. "People in Evanston have been bragging for years that their boarders pay their taxes," says Hagee. Good candidates for boarders are students who are happy to rent rather than live in a college dormitory and who often will take on maintenance chores in return for a lower rent.

8. Convert your home to a rental property and move to a less costly apartment. The IRS allows you to deduct all expenses (insurance, maintenance, repairs) on the rental property, as long as the deductions don't exceed the rental income, says Robert S. Griesman, a tax partner with GrantThornton in Chicago.

If it's your principal residence, you should be able to keep the benefit of tax-free reinvestment of any profit from a later sale of the home, provided you don't rent it out for more than two years immediately before a sale.

If you do decide to rent out your home, be warned that all renters won't take care of it as well as you do and you may end up having to put some money into rehabbing the house when the renters vacate.

9. Use only one income to qualify for a mortgage, even if you're a couple with two salaries. If you've got a second salary to draw from, consider squirreling it away. Even in a good economy, one-half of a couple may want or have to stop working. If you decide to use both salaries to qualify, don't take all the mortgage money a lender is willing to give you, suggests Hagee.

10. Take a no-points loan. With mortgage money plentiful and interest rates very low, home buyers - especially first-timers who have little cash on hand but want to get into the market - can cut costs with low- and no-points loans, says Kenneth Deutsch, president of BancTrust Inc., mortgage brokers. "For example, a 3-point loan of $150,000 would cost you an extra $4,500 upfront," he says. Instead, you can often get a slightly higher interest rate with fewer points.

11. Make a bigger down payment on a 30-year mortgage or take a shorter-term mortgage. If you can scrape together a bigger-than-usual down payment, you may lose some of your income tax deduction on mortgage interest, but you might gain greater peace of mind - especially in this era of wage freezes and job layoffs. Likewise, taking a shorter-term mortgage, which will save you on interest payments and build equity faster, is another option. "We encourage buyers to take 15-year rather than 30-year mortgages," says Hagee.

12. Refinance and take advantage of low interest rates. This may be the favorite mode of saving now. At 8.25 percent, the monthly principal and interest payment on a $100,000, 30-year mortgage is $751, versus $915 on a 10.5 percent loan.

Homeowners, however, need to know that when they refinance they won't be able to deduct points all at once, but will have to amortize them over the life of the new loan, says Abeles. An important question, he says, is how long an owner plans to stay put after refinancing. "If it's for one or two years, it doesn't make (as much) sense as it does if the owner plans to stay for a number of years."
GRAPHIC: PHOTO: Cari Myers of Highland Park scaled back by moving to a much smaller house, which is "quite cozy and homey," she says. Photo for the Tribune by Timothy Boyle.
PHOTO: Barbara Strauss Cowan and her fiance, Jim Herst, will stay in her small North Shore condo after they marry. Photo for the Tribune by Hank DeGeorge.

PHOTO: Interior designer Cathy Kominsky recommends durable carpeting and wallcoverings to trim maintenance time and money. Photo for the Tribune by John Giannini.
The simple life
12 ways to stretch your housing dollar
On the cover: Illustration by Richard Osaka.
LOAD-DATE: 01-05-92

Evidentiary Exhibit Number 201

Newsday (New York)

July 6, 1991, Saturday, ALL EDITIONS

SECTION: REAL ESTATE; Pg. 30

LENGTH: 1906 words

HEADLINE: Road To Recovery;

Lenders involved in turnarounds hope stronger finances will boost co-op sales

BYLINE: By Joe Catalano. Joe Catalano is a free-lance writer

BODY:

IN LATE 1989, residents of Hampton Court realized that their co-op - in Kew Gardens, Queens - was in financial trouble.

The sponsor of the 315-unit property had fallen behind on monthly maintenance payments on the 276 unsold units, said Karen Mazza, treasurer of Hampton Court's board.

Because of the shortfall, the board didn't have enough money to pay interest on the building's underlying mortgage. Shareholders feared that the lender would foreclose on the mortgage, meaning that purchasers would lose their equity and would have to immediately pay off their own mortgages. The building would have reverted to a rental.

"It was a very nervous time for shareholders," Mazza said.

But today, Hampton Court is back in good fiscal health.

The comeback started when CrossLand Savings Bank, which held both the underlying mortgage and the mortgage on the unsold units, declared the sponsor in default and took possession of his apartments. Since late 1990, CrossLand has made the maintenance payments on unsold units, said Brian Warwick, an assistant vice president.

Between 400 and 500 co-op buildings in the New York metropolitan area have experienced financial difficulty since late 1989, said Frederick K. Mehlman, chief of the real estate financing bureau in the state attorney general's office, which oversees condo and co-op offering plans. In recent years, the co-op market has suffered along with city real estate in general, and the weakness has been reinforced by the negative publicity generated by financially troubled co-ops.

No one knows how many of those properties are financially healthy again - including Mehlman, whose office is working with many properties to come up with solutions. But, clearly, solutions are being reached in increasing numbers.

Stuart Saft, a partner in the Manhattan law firm Wolf Haldenstein Adler Freeman & Herz, has worked with about 40 financially strapped buildings, including Hampton Court. All but six are now on sound footing, Saft said, and he hopes to nurse the others back to health by September.

Mehlman said one successful reclamation involves the first buildings to report problems - the approximately 100 being converted by Time Equities, a Manhattan firm. Those properties "are on pretty solid ground again," Mehlman said. Various lenders are paying the maintenance on the unsold units Time Equities defaulted on.

While much has been reported about the hundreds of co-ops and condominiums in the city that have encountered financial trouble, little has been said about the buildings that have faced their problems head-on and are now near or back in sound fiscal condition.

Lenders and others involved in these turnarounds hope that strengthened finances, combined with other incentives such as reduced operating costs, will boost sales of unsold units - particularly to existing tenants who, under conversion laws, can continue to rent their units as long as they want.

Operating costs at Hampton Court were lowered when contracts for landscaping and other services were renegotiated. The sponsor had given those jobs to subsidiary companies he owned; switching companies resulted in savings of up to 40 percent, Mazza said.

As a result of these and other cost-cutting measures, the monthly maintenance charge has been reduced. Warwick said this will make the unsold apartments more desirable when CrossLand begins marketing them. CrossLand expects to do that soon, after its amended offering plan is approved by the state attorney general's office. Warwick said a primary marketing target will be rental tenants at Hampton Court who have resisted buying their units.

There is evidence that the market is improving. Halstead Property Co., a Manhattan broker, recently reported that the number of closings on Manhattan residential properties for April and May were more than double the number in January and February. The two periods, the report said, "were respectively the busiest and the slowest for property transactions in the last five years."

And even if sales remain lackluster, observers say lenders who have foreclosed and taken over unsold shares - the most common method of restoring a building's financial health - are more willing and able to absorb losses than the sponsors who got into trouble.

Besides lender foreclosure, another common scenario is for the residents themselves to go to court and force the sponsor out, gaining ownership of the unsold units. Proceeds from the sale of units are used to repay the co-op's debt, said Marc J. Luxemburg, a partner in the Manhattan law firm Snow Beck Krauss, which is working with six ailing co-ops.

Many financial solutions also include reductions in operating costs, Saft said. They include:

Persuading the lender to lower the interest rate on the building's underlying mortgage.

Examining the leases for commercial areas found in some buildings. Often the sponsor retains the space, paying the co-op a low rate. The leases are adjusted to market value as they expire.

Hiring new vendors, not connected with the sponsor, that can perform services such as landscaping for less money.

Cutting operating costs reduces monthly maintenance payments so that unsold units become more affordable and desirable to own, Saft said. Buildings that have achieved cost savings are, in many instances, emerging in better financial shape than before their fiscal difficulties began, Saft said.

This can be an important edge in countering the negative image co-ops have acquired since problems at some buildings surfaced. Many city buyers have shunned co-ops, in part because of buildings' guilt by association, said Charles Rappaport, president of the Federation of New York Housing Cooperatives. But the reality, he said, "is that over 95 percent of co-ops and condos are financially sound places."

Said Luxemburg, "A lot of good co-ops have suffered unnecessarily even though they've had a strong sponsor."

In Queens, which has more troubled co-op units than any other area of the city, Borough President Claire Schulman and her staff have been criticized for their focus on the crisis. "But the situation can't be solved without the negativity getting out," said Dan Andrews, a spokesman for Schulman's office.
IT ISN'T KNOWN how many of the 20,000 troubled units in Queens have rebounded, said Andrews, whose office has been involved in workout negotiations. But Queens success stories, besides Hampton Court, include the 747-unit Hyde Park Gardens in Kew Gardens Hills, where the lender foreclosed and is now paying maintenance while selling units again. Many of the sales have been to existing tenants.

One Manhattan turnaround involves seven buildings in Tudor City that were part of the initial wave of Time Equities buildings that reported problems. When it was disclosed that the sponsor had fallen behind on maintenance payments, "Tudor City was pictured in all the media," said Mary Frances Shaughnessy, managing director of Tudor Realty Services Corp., which manages four of the buildings.

"The initial reaction of residents was terror," said Shaughnessy, a unit owner and, at the time, an employee of the sponsor. "For a year, you couldn't sell a unit here."

But one of the original sponsors, who had mortgaged his unsold shares, lost them through foreclosure while a partner, prompt with his payments, remains. Shaughnessy said nearly all financial problems have been worked out, with three lenders paying, or about to begin paying, maintenance on the unsold units, which represent 40 percent of the total of 2,557. Resales are occurring again, although at lower prices. Studios that had sold for $ 75,000 at the height of the market now go for about $ 40,000, roughly the same as the price for rental tenants to buy units when the co-op conversion began in 1987, she said.

But Shaughnessy expects prices to rise as the market picks up because the lenders are renting the unsold units at Tudor City, even when they become vacant, instead of selling them at fire-sale prices, which would further depress the market. When a tenant moves from an apartment in a co-op, it becomes decontrolled and can be rented at market value, creating a better cash flow for the sponsor.

Another Manhattan building battling back to fiscal health is the 90-unit co-op known as 446 East 86th Street. Steven Weissman, president of the co-op board, said Luxemburg was hired in March, 1988, and the lawyer filed a suit against the sponsor, who had fallen behind on maintenance payments and other obligations. A year later, a judge awarded the sponsor's 19 unsold apartments to the resident owners.

To help eliminate the debt, a $ 500,000 line of credit was secured, Weissman said. In addition, two of the newly acquired vacant units were sold. The co-op is negotiating to sell the remaining 17 apartments - five vacant and 12 occupied by rental tenants - to a single buyer, Weissman said.

"We haven't made a total recovery, but we know the end is near," Weissman said. "It's taken a lot of effort because we didn't have the luxury of a bank holding a mortgage on the unsold shares to come in and rescue us." The sponsor had secured a loan from the former owner of the building.

Financial problems haven't been limited to conversions. Some newly constructed buildings have suffered - and recovered - as well.

CitySpire, a 75-story condo on 56th Street in Manhattan, began selling its 352 units in 1987. By 1989, the sponsor had fallen behind on common charges and other obligations, said Raymond Cuminale, president of the board of managers. Last year the condo placed a lien against the sponsor's unsold units to obtain payment.

While residents awaited court action on the lien, the sponsor filed for bankruptcy earlier this year, Cuminale said. Residents feared that they would get a reduced amount or nothing from the lien filing, or that the case would drag on for years. But because the lien had been filed before the bankruptcy, the condo board was immediately able to recover $ 700,000, or 75 percent of the money the sponsor owed.

European American Bank is paying the common charges on the 67 unsold units, and a trustee has been appointed to decide whether to rent or sell the units.

"We are pretty near financial stability," he said.

Vendors to whom the sponsor owed money have been reimbursed. Apartment prices have held up, Cuminale said. Late last year, a two-bedroom unit that originally sold for $ 800,000 was resold for $ 1.2 million, Cuminale said.

One positive development resulting from the financial crisis is that many owners are paying more attention to what's going on at their condos and co-ops, said Rappaport of the Federation of New York Housing Cooperatives. Buyers are also scrutinizing a building's financial condition - as they should have been doing all along, Rappaport said.

Rothman of the Council of New York Cooperatives sees another welcome result: Defaults have allowed unit owners to take over their buildings sooner. Normally, unit owners don't gain control of the board until at least 50 percent of the units are sold.

No one has lost an apartment because of sponsor default, although one building, 145-149 Ea. 61st St. in Manhattan, has a foreclosure judgment against the underlying mortgage. A solution is being sought, Mehlman said. But, in general, he said, "New York banks have been very responsible and willing to negotiate solutions."
GRAPHIC: 1) Newsday Photo by Mitsu Yasukawa- Steven Weissman, board president of co-op known as 446 East 86th Street. 2) Newsday Photo by Richard Lee- Co-op board president Deborah Vermooten, left, and treasurer Karen Mazza at Hampton Court in Kew Gardens, Queens. The 315- unit building has cut some operating costs 40 percent. 3) Newsday Cover Photo by Jim Cummins- Mary Frances Shaughnessy at Tudor City where lenders stepped in to solve money woes

Evidentiary Exhibit Number 201

Chicago Tribune

June 22, 1991, Saturday, NORTH SPORTS FINAL EDITION

SECTION: HOME GUIDE; Pg. 16; ZONE: CN; Realty Q&A

LENGTH: 1682 words

HEADLINE: Mortgage brokers come through, but beware of empty promises

BYLINE: By Robert Bruss

BODY:

Q - Why are you so tough on mortgage brokers? We recently bought our first home with the help of a wonderful mortgage broker. Our problem was my husband went bankrupt about two years ago, due to business reverses, and we had some late pay problems on our credit report.

This mortgage broker, recommended by our real estate agent, straightened out our credit report and also arranged a 95 percent mortgage, so we only had to make a 5 percent down payment. Why don't you go easier on mortgage brokers?

A - Some of my best friends are mortgage brokers. I have nothing against them. But I frequently receive letters from readers who have been victims of mortgage brokers who promised to arrange loans which proved to be unavailable.

Some dishonest mortgage brokers will promise virtually anything to get a loan application which they can shop around among mortgage lenders. If a loan can't be obtained, they just say, "Sorry you'll have to get a loan elsewhere." I have personally been a victim of some of these mortgage brokers, most of whom are no longer in the mortgage business, incidentally.

However, the best mortgage brokers don't make promises they can't keep. I have had many very satisfactory experiences with mortgage brokers who delivered the loans they promised. But the difficulty is learning which mortgage brokers are honest and which ones are dishonest.

Q - We rent an apartment in a nice neighborhood where there are several rundown houses. The house next to our apartment building has lots of charm, but it needs work. I've talked to the elderly owner and he says he would sell to my wife and I if we promise to fix up his house which he knows needs work. With a $10,000 down payment, he will carry the first mortgage for 20 years.

At age 72, I think he's being pretty optimistic. My question is how can we get a contractor's estimate of remodeling costs before we buy, so we don't get in over our heads?

A - One method is to make a written purchase offer, including a contingency such as "This offer contingent upon buyer obtaining access to the property to receive satisfactory renovation cost estimates from licensed contractors. Buyer to notify seller in writing within 10 days if such estimates are unsatisfactory." Your earnest money deposit will then be refunded if the renovation bids are unsatisfactory.

Another method, which might be better, since you already know the seller, is to just ask to be allowed to have several contractors give you renovation estimates before you make a purchase offer. But the drawback of this method is you have not locked in the purchase price before spending time obtaining fixup cost estimates.

Q - You often say a lease-option is the best way to buy a house. I even invested $4 in your terrific special lease-option report and was all enthused about the idea. Then I went out and tried to buy a house on a lease with

option to purchase. But I quickly discovered the real estate agents in this town are dead set against lease-options. None had any lease-options available. Since my wife and I have excellent jobs with good incomes, but our savings are only about $3,500, we were hoping for a lease-option. How can we find a lease-option home to buy?

A - Lease-options won't work on every home. For example, before I bought my present home on a lease-option I made lease-option offers on several other houses, but the sellers all said "no" for various reasons. The best lease-option candidates are vacant houses which have been for sale several months, owned by sellers who don't need lots of immediate cash.

As I suggest in my special report, I find the best lease-option source is the "houses for rent" classified newspaper want ads. When you inspect a house you like, ask the owner if you can lease the home with an option to buy.

Tempt the owner with a year's rent in advance in return for a lease- option. Negotiate the highest rent credit you can get, but never less than 33 percent, and the longest possible term, such as two to five years. The best lease-option I ever negotiated is for 15 years, but you can probably do better. Readers desiring my special report "How Home Sellers, Buyers, Realty Agents, and Investors Can Profit from Lease-Options" is available for $4 from NewspaperBooks, 64 E. Concord St., Orlando, Fla. 32801.

Q - About a month ago we closed the purchase of our first home. We were looking forward to owning our home, but instead it has turned out to be a nightmare. The seller was of absolutely no help arranging our mortgage. The first lender's appraisal came in very low. We should have taken that as a warning. But we went to a second lender whose appraiser justified the sales price, so we took that mortgage with terms that weren't as good as the first lender's.

However, our big problem is the condition of the house. We now know the roof was poorly patched to stop leaks which reappeared during a heavy rain. Other defects include defective wiring and plumbing. The seller made glowing reports about how well-maintained the house was and how nice the neighbors are. Lies, lies, lies.

One of the neighbors is a former mental patient who has been convicted of child molestation and the other creates a nuisance by repairing noisy motorcycles in his driveway. We talked to our lawyer about canceling the sale, but she said we really don't have a case of misrepresentation. But we owe the seller about $45,000 on a second mortgage, so we are wondering if we can at least get a price reduction?

A - Now you know some of the dangers of buying a home from a FSBO (pronounced FIZZBO) for-sale-by-owner seller. I strongly recommend home buyers (as well as home sellers) work with real estate agents because agents are obligated as fiduciaries to inform buyers of adverse material facts about a home.

I'm sure you felt you were saving money by purchasing direct from the FSBO. But now you know why that was a very expensive mistake.

It sounds as if there was misrepresentation by the seller of many aspects of the home sale. However, your difficulty is proving the seller knew of the problems and then lied to you. Before giving up, I suggest you consult several local real estate lawyers about your legal rights to either rescind the sale or receive monetary damages from the seller.

Q - You seem like a pretty smart fellow, but you really blew that answer to the question a few weeks ago about whether home buyers should get as big a mortgage as possible or pay the maximum down payment they can afford. While the reasons you gave, the maximum income tax deductions and leverage advantages, were good you left out the most important reason which is inflation. Every year the dollar loses at least 4 or 5 percent

in purchasing power. Home buyers who obtain the maximum mortgage will be repaying their loans with cheaper inflated dollars. How could you have forgotten that key reason?

A - Shame on me. You are absolutely correct that inflation is another major reason for obtaining the maximum available mortgage when buying a home.

Q - I took your advice and bought a house to fix up. Now it sparkles. Within a few days the new landscaping should be finished, including the new white picket fence you recommend. I spent about $8,500 on painting, carpets, appliances and will spend about $1,500 on landscaping. The bank's appraiser says the house is worth at least $25,000 more than I paid about three months ago. Do you think I should sell the house or should I keep it as a long-term rental investment?

A - Congratulations on your very profitable investment. You more than surpassed the criteria of increasing market value by $2 for each $1 spent on improvements. Now you have the pleasant task of deciding whether to sell or hold.

What I do is put my fixup houses on lease-options after I have completed the upgrading. Then I let the tenant decide whether to buy the house this year or perhaps next year. Either way, I win.

But I only lease the house for one year at a time. If the tenant isn't ready to exercise their option at the end of 12 months then I reserve the right to raise the rent and the option price. Some tenants take two or three years to get their act together and buy the house. Meanwhile, I get the tax benefits plus any annual increase in market value. However, if you really want to sell the house, give the tenant a 100 percent rent credit (instead of the 33 percent I usually give) to be almost certain the tenant will exercise the purchase option.

Q - As a home seller I disagree with your recent advice to give the best real estate agent a 90-day listing. My wife and I recently sold our home. We followed your advice about interviewing at least three local realty agents before listing with the best one. But the first three we chose were flakes. So we interviewed four more.

Finally, we found a very successful agent who has been selling homes in our area for about 18 years. He has made a ton of money, but is still very enthusiastic. He suggested listing our home for sale with him for only 30 days. After 30 days he said he will either have sold the house or he will have worked so hard we will feel guilty if we don't renew for another 30 days. That is exactly what happened. At the end of 30 days we were so pleased with this gentleman we gladly renewed our listing for another 30 days. One week later he sold our home. It was a delight to work with him. I just wish all real estate agents were so professional and hard working.

A - I'm glad you disagree with my advice to sign an exclusive right to sell listing for not more than 90 days. Your real estate agent has an unusual approach, but one which is very admirable. Most real estate agents are not that self-confident, so they have to rely on longer listings.

The new special report "How to Profit from the New 1991 IRS Starker Delayed Tax-Deferred Exchange Rules" by Robert Bruss is available for $4 from NewspaperBooks, 64 E. Concord St., Orlando, Fla., 32801.

This story is a composite of versions published in the various zones.

Evidentiary Exhibit Number 203

The Washington Post
April 20, 1991, Saturday, Final Edition
SECTION: REAL ESTATE; PAGE E21; HOUSING COUNSEL
LENGTH: 1178 words

HEADLINE: Preserving the Capital Gains Tax Rollover in a Slow Sales Market

SERIES: Occasional

BYLINE: Benny L. Kass

BODY:

Q. In May 1989, we bought a new house. It was our intention to fix it up to our satisfaction, and then sell our old principal residence. Unfortunately, because of market conditions, we have been absolutely unable to sell the old house. Finally, we rented it for one year and in the last few months have again actively tried to sell the house.

We understand that we must sell our old house by May 1991 or we will lose the capital gains rollover. Can you explain and clarify this situation, and is there anything we can do? We have a lot of potential profit in our old house.

A. Unfortunately, this is not an isolated problem. Many people are now finding themselves in a quandary because to preserve the rollover under tax laws, no more than two years can elapse between the time you buy a new principal residence and the time you sell your old principal residence.

The tax laws do not care whether you buy first and then sell, or vice versa. The bottom line is that no more than two years can pass between the purchase and the sale.

There are, of course, some limited exceptions. If, for example, you were on active duty with the military, the two-year period can be extended up to eight years, depending on certain circumstances, including whether you were in the United States or stationed abroad.

But, if you were not in the military, then the two-year period is mandatory. Many court cases have made it quite clear that since Congress spelled out the two-year limitation, only Congress can change that period of time.

Thus, we have to find creative ways in which to avoid having to pay the capital gains tax on the profit that is made when your old house is sold. Keep in mind that currently the federal tax law caps the tax rate at 28 percent of the profit you have made. This does not, of course, include state taxes that may also have to be paid.

If you bought your house for $ 35,000 many years ago, and it is now worth $ 300,000, you have made a gross profit of $ 265,000. Even if you take away such closing costs as real estate commissions, and transfer or recordation taxes, it is still conceivable that you may have to pay as much as $ 60,000 to $ 70,000 in tax to the Internal Revenue Service.

Here are some suggestions for you to consider:

First, you can let the property become a rental investment. If you believe the property has significant appreciation potential and is in a good location where you can command a decent rental income, you may want to rent the property and keep it for a longer period of time.

If you decide to later sell the rental property, you could take advantage of another provision of the Internal Revenue Code, namely the "like-kind" exchange. This approach has similar qualities to the rollover, in that you can defer the profit if you obtain other investment property.

Some people are also considering keeping the property for their lifetime, since on their death, their heirs inherit the property at what is known as a stepped-up basis. In other words, if your children inherit the property and it is worth $ 400,000, their tax basis is the value at the time of your death. Thus, all profit would be nontaxable for your heirs.

Unfortunately, this approach means that you have to carry two houses -- your new one and the old one. Many people are just unwilling or financially unable to make this financial commitment.

Second, you could sell the property to a friend or relative. This is risky, since I do not know of any legal authority whereby this approach has been approved. This is not to say that it cannot work, but you take the risk if the IRS ever decides to audit you.

If you do go this route, you must make sure that, to the best of your ability, you are treating your friend or relative on an arms-length basis. In other words, would you sell that same property to a stranger under the terms and conditions that you are selling the house to your friend or relative?

You should also make sure that your friend or relative understands the situation, and that when the property is ultimately sold, you are the beneficiary of the sales proceeds -- and not your friend. The best way to handle this situation is for you to take back a promissory note and deed of trust securing your equity against the house. You should discuss this situation with your current lender, since there is probably a "due-on-sale" clause in your current mortgage documents, and the sale of the property to your friend or relative may trigger that "due-on-sale" clause. Under such circumstances, the lender would have the right to call the entire loan due, which obviously would be a problem for you.

Most lenders will be willing to cooperate if they have been given advance notice of these facts.

A third procedure is for you to set up a Subchapter S corporation, which is controlled and owned by you. You then sell the property to the Subchapter S corporation.

For example, say your current house is worth $ 300,000. Your existing mortgage is about $ 100,000. You sell the property to the Subchapter S corporation for $ 300,000. The Subchapter S assumes the obligation of your current mortgage and gives you a second mortgage of $ 200,000. A promissory note is signed by the Subchapter S, whereby the Subchapter S agrees to pay you interest on the note until the property is sold. I suggest that a safe harbor interest rate would be at least 9 percent. However, the mortgage payments do not have to be monthly, and they can be payable yearly, or even when the house is ultimately sold. In my opinion, in today's market conditions, this is a commercially reasonable way of conducting business.

Make sure that the Subchapter S has adequate homeowner's insurance in the event of a fire or other casualty. You also have to obtain your lender's prior approval of the "transfer."

If the Subchapter S ultimately sells the house for $ 400,000, it has made no profit. If, on the other hand, the Subchapter S sells the house for $ 450,000, then it will pay the capital gains tax on the $ 50,000 profit -- but clearly the profit for the Subchapter S is much less than the profit you have made.

By conveying your property to a Subchapter S corporation, within the two-year mandatory time limitation, you have complied with the rollover requirements of the Internal Revenue Code.

Several years ago, the IRS indicated in a private letter ruling that this would be an acceptable way of meeting the two-year requirement. While a private letter ruling is not binding on the IRS, it certainly indicated the agency's thinking process. No one can guarantee what the IRS will do if it audits your transaction. However, since this procedure has merit, and since the alternative is that you will have to pay the capital gains tax, in my opinion it is worth exploring if you are running up against a deadline.

Benny L. Kass is a Washington lawyer. For a free copy of the booklet "A Guide to Settlement on Your New Home," send a self-addressed stamped envelope to Benny L. Kass, Suite 1100, 1050 17th St. NW, Washington, D.C. 20036.

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HEADLINE: Faster ways to sell your house.

BYLINE: Harowitz, Sherry ; Blum, Adrienne

BODY:

It's not the best of times to sell a house. But believe it or not, it's not the worst, either. Interest rates are low, and there are steps you can take to add luster to a home for sale-tactics that needn't condemn you to accepting a rock-bottom price.

In slow markets sellers often list their houses at what they hope is a realistic price, but assume they'll have to lop off several thousand dollars. Would you do better by lopping that money off the top and listing your home for less? Probably not, contends Janise Fitzpatrick, a broker with Realty World-Bay Path Realty, in Belchertown, Mass. Price cuts are taken for granted in bad markets, and the buyer will probably ask you to go lower anyway.

Instead, look for ways to help the buyer. Don't automatically shy away from unconventional deals. Marle and Bob Coughlin sold their Massachusetts home to the builder who wanted to sell them a new one. Fern and Ross Ippolito had their New jersey house inspected and repaired before a buyer asked them to do it.

The key to success is to start with inexpensive and risk-free enticements, then follow up as you need to with more complex strategies to custom-design an approach that will sell your house. ENHANCE THE PROPERTY Professional sellers spend much more time getting a house ready for the market," says Gary Daniels, of Coldwell Banker Schlott Realtors, in Wayne, N.J. Today that means going beyond fresh paint, spotless floors and a well-groomed yard by offering warranties, inspections and, in some cases, fix-ups. GET YOUR HOME INSPECTED. Having your property inspected before you list it can pay off. Buyers like the idea, and you have time to decide what to do about a problem before the buyer finds it. Ross Ippolito, who found roof damage when he had his two-bedroom ranch house inspected, figures he saved himself from spooking a skittish buyer at the last minute. And he had time to decide whether to cut his price or to fix the problem. He opted for the repair-a wise move because buyers often insist on a discount that's more than the cost of a fix-up.

Your agent should be able to give you the names of home inspectors in your area, or you can look in the Yellow Pages under Building Inspection Services," "Engineers (Inspection or Foundation)" or "Real Estate Inspectors." Inspectors who are members of the American Society of Home Inspectors (ASHI) have agreed to abide by a written code of ethics and by prescribed standards of practice.

Expect to pay $ 250 to $ 350. You may be able to defer payment until closing, even if you hire an inspector on your own. Some real estate firms can also arrange for deferred-payment inspections. OFFER A DECORATING ALLOWANCE. Say you've spruced up the place, but along comes a couple who love the house but hate the carpet and can't stand your wallpaper. Offer a decorating allowance-to be paid at settlement-covering agreed-upon redecorating expenses. CONSIDER A HOME WARRANTY POLICY. This protects the buyer by paying for repairs and the cost of replacing heating and air-conditioning systems and major

appliances-less deductibles-for up to a year. The cost: $ 300 to $ 400. Ask your agent for names of companies that offer home warranties. TARGET YOUR BUYER Ordinary ads are of little use when buyers are scarce. So are fliers and the other scattershot approaches. What you need is something to catch the buyer's eye-something that makes your house stand out.

Kathy and Bruce Robbins sold their Centreville, Va., townhouse in just over three weeks, despite a dead market and several other homes for sale nearby. One of the homes, which was nearly identical to theirs, was owned by a relocation company, and the Robbinses feared the company might dump the house on the market for a very low price. The couple succeeded in part because the financial package they offered in the local multiple listing service appealed to investors.

The Robbinses took back a second mortgage in place of a down payment, paid part of the buyer's closing costs and sweetened the pot further with a transferable homeowners' warranty. They closed the sale at $ 167,000, which gave them a net sale price of roughly $ 156,600 after seller concessions.

Two weeks later, the relocator's townhouse sold for $ 147,500. "By taking the initial offer and making it work," says Bruce, "we actually made out better." OFFER FINANCIAL HELP You have a toolbox full of creative financing strategies. Several offer the buyer the advantages of seller financing without the risk to you of playing lender. BUY DOWN THE MORTGAGE RATE. Buy-downs, in which you pay to reduce the buyer's interest rate, can be a powerful selling tool. They aren't complicated, and you avoid the risks of lending directly. They're also relatively cheap.

Best of all, a buy-down may actually help maintain your sale price. Sellers who buy down the purchaser's rate by one percentage point for the full term of the mortgage get roughly 2% more for their homes than do homeowners who don't offer buy-downs, according to G. William Fox, president of Fox & Lazo, a Philadelphia-area real estate company.

The amount you pay to buy down the interest rate for the life of your purchaser's mortgage loan depends on the size of the down payment. Fox & Lazo's affiliated lender, for example, charges 4.75% of the loan amount. The lower the down payment, the higher your cost. Short-term buy-downs-two percentage points off the rate the first year and one point the second year, for example-are cheaper; they cost about 1% of the mortgage for each point you buy down. At closing, you write a check to the lender that covers the agreed-upon portion of the interest charges. The lender holds the money in escrow and credits the interest monthly as payments come due.

Buy-downs can work better than cutting your asking price because buyers get a double benefit: a cheaper mortgage and the ability to qualify for a larger loan. For example, in order to pay a 9.5% fixed-rate, $ 100,000 loan, a buyer would have to make monthly principal and interest payments of $ 841. A one percentage point buy-down-to 8.5%-would cut the monthly principal and interest payments by $ 72, to $ 769. And because lenders use the reduced interest rate to qualify buyers, you make it possible for the buyer to afford about 8% to 10% more house.

Lowering the loan by the cost of the buy-down ($ 4,750, or 4.75% of $ 100,000) doesn't accomplish the same thing. At that amount ($ 95,250), the buyer would make principal and interest payments of $ 801 a month, $ 32 more than with the buy-down.

Treat the cost of the buy-down as a drop in sale price. This should reduce the commission you pay to the real estate agent (your contract should specify a fee based on the net sales price) and the taxable gain on the house. PICK UP SOME PAYMENTS. You can draw buyers-especially first-timers strapped for cash-by offering to pay their principal and interest for several months.

Have the contract worded so that you write a check for the amount at closing. Specify that the money be put in an escrow account with the lender and applied monthly to pay for principal and interest. Sellers in Northern Virginia do th's a lot on homes between $ 100,000 and $ 160,000, says Jessie J. Crevoisler, of Century 21 Camelot Properties, in Vienna, Va. It helps the buyer's cash flow. More importantly, it has tremendous psychological appeal. Buyers like the idea of getting to live for free while you pick up the tab. You treat it as a reduction in price for tax purposes. HELP AT CLOSING. Maybe your buyer isn't concerned about the monthly payment. Maybe he or she has a good salary but not much in savings. In that case, you can offer during negotiations to pick up some closing expenses. But be aware that lenders place a limit on seller contributions. If you exceed that limit, the additional assistance will reduce the amount the lender is willing to finance. wi

A simple and effective tactic is to offer to pay one or more of the points the buyer would have to pay to get a mortgage. Or offer to prepay a year's taxes or, for a condo or townhouse, to pay the first year's common charges. As the seller, you treat these concessions as a reduction in price. Even prepaid taxes get taken off the price, except any prorated share for the time during the year that you still lived in the house. CONSIDER BECOMING A LENDER Helping the buyer at closing is attractive because you don't take on the risks of becoming a lender. But if your buyer can't meet the down payment or other cash requirements, offering financing is your next choice.

Becoming a lender is riskier to you, so you should ask for one to two percentage points above the going first-mortgage rate on any loan you make. In most cases that will still be below the going rate for second mortgages. To protect yourself, limit the term of any loan. Three to eight years is typical. Have your agent check the borrowers' credit rating, financial condition and employment status carefully. Work with a real estate lawyer on the contract terms and financial safeguards, and make final approval contingent on a legal review. Then record a lien to protect your interest. LEND PART OF THE DOWN PAYMENT. If you can help boost the buyer's down payment to 20% with a loan (usually called a take-back, or purchase-money second mortgage), you may make it possible for him or her to qualify for better terms and lower interest rates. A 20% down payment also allows buyers to avoid the cost of mortgage insurance.

The trade-off is more risk. Be very cautious about making a loan so large that it reduces the buyer's equity in the property below 10%. The lower the new owner's stake, the more likely a drop in value could trigger a default on the loan. A second mortgage puts you second in line, behind the primary lender, if the buyer defaults. For your protection, include language in the note and the contract that should the buyer default on any mortgage lien against the property, you'd have the right to default on all of them.

Unless you are financially able to hold a first mortgage, you should consider selling the borrower's note to investors. Expect to accept a considerable discount-at least 20%-because investors want to be compensated for factors such as risk and the time value of money. Treat the discount as a capital loss, which can offset capital gains and up to $ 3,000 per year of other income.

Your real estate agent should be able to help you locate an investor. Consider making final acceptance of the purchase offer contingent on locating an investor to buy the note. Hire a real estate attorney to draw up the loan documents. Use legally acceptable terminology, and whenever possible, standard mortgage documents and terms, write Martin M. Shenkman and Warren Boroson in How to Sell Your House in a Buyer's Market John Wiley & Sons; $ 29.95, $ 14.95 paperback). PROVIDE AN INTERIM MORTGAGE. You can also offer to become the primary or sole lender for a limited period of time. That approach can break a stalemate f you find willing buyers who haven't sold their own home. That's how a seller in Glen Allen, Va., got Karen and Tom Spencer to commit to buying before putting their townhouse on the market.

The Spencers had cash for the down payment but couldn't qualify for a mortgage while still paying on their old house. The seller offered a loan at 10% for one year, with interest-only payments due quarterly and the full principal due as a balloon payment either at the end of the year or when the Spencers' old home was sold-which took only four months. (The seller making the loan treats the interest as taxable income.) GET CREATIVE In lousy markets, sellers must sometimes come up with innovative strategies custom-made for the deal. LET'S MAKE A TRADE. If you've found a home you like and your own place isn't selling, talk to the other owner about a trade. That's what Marie and Bob Coughlin did when they couldn't find a buyer for their seven-room, Cape Cod-style home in East Longmeadow, Mass. Trades can be tricky because there's seldom an even exchange. Builders often insist on taking a steep discount for the traded house. But as the Coughlins found out, sometimes everyone wins.

The house the Coughlins and their three children wanted was a new Cape Cod-style home with a bowed roof and "loads of details that you don't find in most houses these days," says Bob. The builder, Craig Harder, had dropped the price by $ 50,000, to $ 225,000. But all offers for the Coughlins' own house-listed originally for $ 149,900 and reduced to $ 144,900-fell through when prospective buyers couldn't sell their houses.

Finally, Harder offered the Coughlins $ 131,600 (the equivalent of $ 140,000 minus the agent's commission) for their old house. That was a little less than the Coughlins had hoped for, but "we figured we would trade the risk of losing a few thousand dollars of profit on our house for the certainty of closing and getting the house we wanted," Bob says. The builder sold the old house six months later for $ 140,000. HIRE A SITTER. If you have to move into the new house before you can sell the old one, you're at a considerable disadvantage. You're saddled with two mortgages. An empty house is harder to market, and if it sits vacant for too long, your insurance may be canceled. You could rent the place. But the delay may be costly if your market is headed south.

David Holmberg, an Atlanta homeowner, feared that was the case when he took a new job in Wilmington, N.C. Holmberg had tried everything to move his $ 178,000, four-bedroom contemporary home, complete with pool and jacuzzi. "We'd dropped the price several times, to $ 158,000. We'd offered aggressive bonuses to the selling agent. Unfortunately, it still hadn't sold," he says.

Instead, he hired a sitter-or home manager, as they are called-through Showhomes of America, a firm that manages property in 14 cities (800-274-7469). Caretakers of America (303-233-2676) is a similar company operating in about 23 cities. Showhomes matches a house sitter (complete with appropriate furniture) to the house and keeps the place ready to show to prospective buyers. The sitter pays all utilities. In return, he or she pays about 75% less rent than the going rate. The entire rent goes to Showhomes as a fee. The sellers give up the rental income in exchange for keeping the house on the market continuously.

For the Holmbergs, the payoff came quickly. Their old home in Atlanta sold for $ 149,000 within three weeks. BY SHERRY HAROWITZ

RESEARCH: ADRIENNE BLUM LURE A BUYER WITH A LEASE

Home buyers are so scarce in some places that cutting the price of the house isn't the answer, says Claudia Deprez, president of Florida Singles Real Estate, in North Palm Beach. Consider leasing your house instead, and turn the lease into a sale. The easiest but least effective tactic does nothing more than give the renter the right of first refusal to buy the house. Better yet, offer a lease-option. This lets you tap into a wider pool of people: buyers who can handle the monthly payments but don't have enough cash for a down payment. HOW A LEASE-OPTION WORKS. A potential buyer agrees to two things: to lease your house for a specific monthly rent and to pay you for an option that gives him or her the right to buy the place at a set price within the option

period, which is typically six months to two years. Payment for the option-called option consideration-Komes in two parts. First is an up-front payment, which is often 3% to 5% of the price of the house. Second is an amount-typically $ 50 to $ 300 monthly-that is paid in addition to the rent. All this money will be credited toward the purchase price if the option is exercised, and that gives the renter the incentive to become a buyer. If he or she decides not to buy, that money is yours to keep.

Lease-option sellers often get their sale price, even in slow markets. A house in North Palm Beach stayed on the market for only 16 days before being lease-optioned for the asking price. Nearby houses were going at 15% discounts and averaged 160 days on the market. The lease-option buyer, who was waiting for an insurance settlement, bought the house outright in four months. BETTER THAN RENTING? Critics say that lease-options are no better than renting because they take your house off the market. But proponents think tenants who consider themselves potential owners are better caretakers. The couple who took an option on Anne and Julian johnson's Atlanta home have already begun making improvements, permitted in the agreement. "That's reassuring to us," says Anne. "They're in earnest about the purchase because they are spending a good bit of money redecorating, and that's out of their own pocket."

A bigger criticism is that if home values drop, your renters may not exercise the option. You can always renegotiate at the end of the option period. But even if prices go up, you can't be sure they'll buy-which can cause real problems if you've already bought a new home: You must sell your old home within two years of the time you buy the new one or you'll owe tax on the profit when you finally sell the old home. CHECKING OUT THE BUYER. You want to be very certain about how your buyer will qualify for a mortgage when the option term is up. Lenders will generally require that your buyer come up with a 5% down payment in addition to any part of the option consideration credited to the down payment. Your buyer must also have the income to qualify for a mortgage. TAXES ON A LEASE-OPTION. The money you receive as option consideration is not taxable, at least not right away. If the option is exercised, that money is considered part of the purchase price, which means it affects your gain or loss on the sale. If the option expires, however, you must report that amount as taxable income in the year the option expires.

The part of the monthly payments not attributed to the option is rental income. It's taxable, but you also get to deduct rental expenses (see "Can't Sell Your House? Rent It," March, for more on the taxation of rental income).

Make sure the lease-option is drawn up by an attorney so it won't raise legal or tax questions. Also check with your lender before you set up a lease-option arrangement. You don't want your lender to treat the arrangement as a sale during the lease period because that could prematurely force you to pay off your mortgage. YOUR BROKER-. UPPING THE ANTE

Like everybody else, real estate agents have been hit by hard times. So some companies will negotiate commission fees. But contrary to common sense, many agents are actually raising rates, arguing that homeowners need more help when buyers are scarce. Realty World Countrywide, in San Marcos, Cal., charges up to 7%, with 4% going to the agent who finds the buyer. Some commissions in New York City hit 10%, says Patrick Tyson, of Century 21 Lewis 'N Clark Realty.

Century 21 Dorchester Associates, in Boston, encourages sellers to add $ 2,000 to the standard 6% as a bonus for the selling agent. Other firms use gimmicks such as the 10K program. Home sellers kick in $ 250 at closing, part of which goes for marketing. The rest goes into a pot, which is awarded in $ 10,000 chunks to participating selling agents.

You don't have to buy the argument that paying more is the way to go. There are still many homes fisted at 6%. To get the most for your money, use the following guidelines: * If you pay a larger-than-normal commission, make sure you get a top-selling agent with a track record of moving homes even in a bad market. Plus, you should get extra services. Denver's Coldwell Banker Professionals includes inspections, appraisals, warranties and decorating help. * Insist on a short listing period (60 to 90 days). If the broker doesn't work hard, find someone who will. * Get in writing the way the agent will show the house and the placement, type and frequency of ads. * Insist that your house be listed in the multiple listing service quickly, usually within 24 or 48 hours. * Make sure the broker is knowledgeable about financing options. * Look for innovative marketing, such as the ten-day "red hot summer sale" with extra advertising that Bowers, Nelms & Fonville, in Richmond, Va., ran at no extra cost to clients.

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A HUMBLE ABODE? NOT TO THOSE WHO BUY THEM

BYLINE: By SUSAN GEMBROWSKI

BODY:

When Kay Piotrzkowski moved from Oregon to San Diego, she spent two years living in apartment complexes and condominium projects. Then, last year, she bought a mobile home in Encinitas.

"I tried apartment living and decided I didn't enjoy having the common walls," Piotrzkowski said. "I looked for a (mobile home) park where I could buy the lot."

Piotrzkowski settled on Park Encinitas, a 155-space park purchased by its tenants in 1985. Her home is within walking distance of shopping centers, has reasonable homeowner association fees and includes the use of amenities, such as a clubhouse and a swimming pool.

And it was affordable.

The purchase price of $83,000 for the 20-year-old, two-bedroom, single-wide included the land. The cost ranks far below market value of a single-family home with a comparable amount of living space.

Piotrzkowski is not alone in her calculated decision to settle in a mobile home.

North County has about 170 mobile home parks. The majority of park dwellers are seniors, but there are also parks attuned to families and younger singles.

In most mobile home parks, the lot spaces are rented but the homes are owned by the people who live in them. Increasingly, though, mobile home owners are buying the parks where they live.

Once, mobile homes really were mobile. They were built on wheels and could be hooked to the back of a truck and pulled down the road.

Today's mobile homes typically are not mobile at all: They are called "manufactured housing" and have only moved once -- from the factory where they were built to the lot where they are set up.

The homes, sometimes indistinguishable from those built on site, often feature spacious living rooms with vaulted ceilings, formal dining areas, laundry rooms, kitchens with breakfast nooks, and bedrooms with walk-in closets and dressing areas.

The process of moving a mobile home has become expensive and complex. That lack of mobility has made them especially vulnerable to rent increases.

Several cities in North County have stepped in to preserve mobile home parks as a source of affordable housing. Poway and other cities have become park landlords; Oceanside and Escondido have adopted rent controls and San Marcos has a Mobile Home Rental Review Board.

Although there are no new rental parks being built -- rising land costs and the price of development have made them unfeasible -- there has been an increase in new subdivisions catering to manufactured housing. The lot and home are purchased together, much as they would be in a conventional new housing development. The subdivisions have attracted younger, first-time buyers who find they can afford to buy into them.

"There are as many different types of mobile homes as there are automobiles," said Vicki Armstrong, owner of Expert Mobile Home Brokers. "It is a whole different product than it used to be."

Some mobile home parks are bare-bones operations; some have country-club luxuries.

Here is a look at how mobile home living has evolved in North County:

RESIDENT OWNED PARKS

Carol Pollock, Vivian Cohagan and Mary Sanelli grabbed paint brushes recently and voluntarily refurbished the clubhouse kitchen at Vista Cascade, a resident-owned mobile home park in Vista.

Pollock, 70, and Cohagan, 76, previously painted two card rooms in the clubhouse.

"It all belongs to us so it's an improvement on (the quality of) your life," said Pollock, a park resident since 1980. She planned the champagne party last April when 102 park residents banded together to form a nonprofit corporation to purchase the park.

In recent years, 16 parks in North County have been bought by mobile home owners in Encinitas, Carlsbad, Fallbrook, San Marcos, Vista and Escondido.

"North County has a higher percentage per square mile of converted parks than any other county in California," said Don Olmsted, former regional director for the Golden State Mobilhome Owners League, a tenants' group.

Many of the conversion parks allow residents to purchase their individual sites while others sell a share of the cooperative.

"We tried to buy the park seven years ago, but couldn't come up with the $1 million and the bank wouldn't loan the money," Vista Cascade board member Martha Hancock said. "We signed an 18-year land lease with the (former) owner and just rented the business. In 1989, when the owner decided to sell, we tried to purchase the park (again). We had 15 days to do it and it was right at Christmastime so we weren't able to buy it."

Eventually, the residents struck a deal with the new owner. They secured a loan from the Bank of America, and for $5 million and the initial investment of $3,500 per resident, the residents bought their park.

Last weekend they celebrated their one year anniversary of park ownership with a party attended by about 80 residents and Vista Mayor Gloria McClellan.

"Neighbors are close. They watch out for you," Pollock said of her decision to purchase in Vista Cascade. "You meet a lot of friends. You don't all participate in all the activities. You have a choice. We have bingo once a week, bridge, pinochle and cribbage. We have a monthly dance with our own band, the Cascadian Stompers, who are most all residents. Park living is ideal."

Another park purchased by residents is Oak Crest Estates, Inc., a 105-space cooperative in a secluded valley near Interstate 15 in Fallbrook.

Of the three mobile homes currently for sale in Oak Crest, prices range between $55,000 and $100,000.

The former rental park was owned by the California Department of Transportation. A nonprofit corporation was formed in 1984 and residents bought shares in it. The residents own an interest in the park rather than an individual lot.

Administrative fees, which replaced the former rent scale, have remained at $120 per month since the cooperative was formed, said office secretary Rosalie Hennig.

Fees include trash, water and common area maintenance. Residents pay an additional cost of $7.50 per month for cable television. Common areas include a swimming pool, a Jacuzzi, a clubhouse with a pool room and a library, and shuffleboard courts.

"There is a growing movement throughout California for people to buy their own parks," said Marty Orenyak, community development director of the City of Carlsbad. "Every park (there are seven in Carlsbad) has explored with with us the possibility of buying their own park. Mobile home parks are as close to affordable housing as you can get anymore."

LUXURY RENTAL PARK

Rancho Carlsbad Country Club displays the park name on a stone gateway lined with trees.

The neatly manicured lawns, wide meandering streets, and stretch limousines and Mercedes-Benzes parked in the driveways alter a first-time visitor's image of what a mobile home park should look like. The gated community with 504 spaces has 24-hour security covering the 106 acres of park land.

Although monthly lot rental fees are stiff -- between $610 and $850, which includes water, trash, sewer, cable television and all facilities -- residents say the price is worth it.

"It's the kind of place where you feel you're almost always on vacation really," said resident Esme Simes.

Amenities at the park include a fully-equipped exercise room with locker rooms and saunas for men and women. A 62-foot diameter circular heated swimming pool complements a Jacuzzi, which seats 30 people. The 12,500-square-foot recreation center includes two arts and crafts studios, including a pottery room with kilns for firing, and an enclosed area with four shuffleboard courts.

A community clubhouse can be reached by crossing a lake filled with birds and ducks on a lighted, arched walkway bridge. The 13,500-square-foot clubhouse has a fully-equipped restaurant-style kitchen, a pool room, a library and reading room, a ballroom, where monthly dances are held, a card room for bridge and poker players and a lounge, where free movies are shown every Friday night. The Bank of North County offers banking services at the clubhouse every Tuesday morning.

In addition, Rancho Carlsbad adjoins an 18-hole public golf course and discounted rates are offered to park residents. Other park amenities include tennis courts, horseshoe pits, picnic grounds and a gardening area. In the 20-by-20 foot individual plots, members of the Garden Club raise vegetables and flowers.

"I've become a farmer in my old age," resident Helen Franklin said, as she prepared to plant vegetables with the help of her friend, Minde Newman.

Group activities include dance lessons by resident Mary Jo Holland. The eight-member tap dancing troupe, called the Ranchettes, with dancers ranging from age 57 to the mid-70s performs once a month throughout the county.

"This is like living in heaven," said resident Jane Bailey, as she practiced a duet in the clubhouse ballroom with Naomi King for an Easter performance of the 30-member singing group, the Mobile-Aires, who are all park residents.

Purchase price of mobile homes in the park range from $38,500 to $90,000, according to Simes who is licensed to sell mobile homes as well as real estate.

Currently, the park houses four brand-new homes, which range in size from 1,344 to 1,945 square feet. An addition to the park of 100 spaces and a new sports complex is planned for the near future, Simes said.

The country-club style park is not for everyone, points out Johns Vincent, a mobile home dealer in Vista. He said some park residents moved to other sites in Carlsbad and Hemet in recent years because of the high rents needed to finance the amenities.

FAMILY RENTAL PARKS

Although 90% of rental parks in North County cater to seniors, families and younger singles can rent sites in about 23 parks.

El Camino 76 Family Mobile Estates in Oceanside falls in the family-park category.

The 80-space park, built approximately 20 years ago, has a clubhouse, tennis courts, a children's play area, a swimming pool and a laundry facility.

"About 80% (of the coaches in the park) are double-wides," park manager Don Cooper said, adding that a third of the tenants no longer have children at home.

The average double-wide mobile home sells for about $35,000 to $45,000 and the single-wides sell for approximately $20,000, Cooper said. Because of the scarcity of family parks, many of the mobile homes command a higher purchase price, he said.

Lot rents average $230 per month and do not include sewer, trash pick-up or cable television.

"We don't have a lot of coordinated activities," Cooper said. "It is not very practical in a family park with younger people who need to work five days a week. On the weekends, they want to enjoy their own families. There is no time for coffee klatches or knitting circles as in the senior parks."

Cooper feels the family park offers "more peace and quiet" than an apartment complex and is safer and more secure.

"People in mobile home parks are more aware of who belongs in the park and who doesn't," Cooper said. "One reason is that the turnover in mobile home parks is substantially less than in apartments. In the last 15 months, only two (mobile homes in the park) have been sold."

CITY-OWNED RENTAL PARKS

In an effort to preserve affordable housing, the Poway City Council has purchased three of the five rental mobile home parks in the city, according to Reba Wright-Quastler, director of planning services.

"We're buying them from the park owners and renting them to the people in order to stabilize rents," Wright-Quastler said.

The decision made Poway the first city in the state to become landlords in mobile home parks.

The city paid a total of $8.5 million for Poinsettia Senior and Poinsettia Family mobile home parks. The purchases were completed in July, 1988. On Jan. 15, the city closed escrow on Poway Royal Mobile Estates at a cost of $21.6 million.

Back in 1985, Poway residents asked the city council for rent controls as they were being economically evicted from their homes, Wright-Quastler said. The gap between their incomes and the cost of the parks prohibited resident purchase of the parks.

"Through tax-exempt certificates of participation, the city bought the parks and was able to bring the financing down," Wright-Quastler said.

Renters in the two Poinsettia parks pay approximately $329 for their spaces, while those in Poway Royal are on four different rent scales with the average being $416, including sewer charges. The planning services director admits that if the city keeps the park rents artificially low it may ultimately increase the value of the mobile homes in those parks. However, a long term plan is being studied with one option to sell the sites to the residents.

"There are a number of things to decide," Wright-Quastler said. "I don't know what we're going to do long term."

In the meantime, the Poinsettia parks house 260 spaces with approximately one-half reserved for seniors and the other half rented to families. The family park has a playground and offers children's activity classes during the summer months.

Both parks have clubhouses and swimming pools. At Poway Royal with 400 spaces, there are tennis courts, two clubhouses, two swimming pools and a well-maintained recreational vehicle parking area.

Poinsettia Family Mobilehome Park resident DeAnn Evans, 29, spent part of her childhood in the park. She makes her home there now with her husband, David, and their two sons, age five and three. The couple bought a mobile home six spaces from DeAnn's mother's.

"We purchased here because of the affordability and because it had a yard," Evans said. "The City of Poway is trying to get more organized activities. At Christmas, there was a big, huge party for the kids. At least 75 kids showed up. Last summer, for the first time, they gave swimming lessons (for the children). This summer, they're planning on offering more activities for kids."

Other cities have recently joined Poway in purchasing parks, including the purchase Jan. 2 of The Views in Escondido and the February 1990 purchase of the 112-space Sycamore Creek Mobile Home Park in Vista.

The Sycamore Creek land abuts the historic Rancho Buena Vista area. Wyvetta Wilson, housing community development specialist for the City of Vista said that the mobile home park will eventually be phased out and the land redeveloped as parkland and open space. Meanwhile, for 12 to 15 years, the residents will have stability in rents.

Lot rents at the city-owned Vista park range from $261 to $308, Wilson said.

A few spaces are rented on a monthly basis to RV owners, who may stay up to 7 months.

In San Marcos, the city became a partner with the homeowners in the purchase of their parks, according to deputy city manager Paul Malone.

"Mobile home parks were a big priority to the city council," Malone said. "With redevelopment funds, we bought the spaces in parks outright and we lease them back to the residents for a nominal fee that varies depending on their income."

Currently, the city owns 12 to 15 sites in Madrid Manor Homeowners Assn., Malone said. The city may also purchase some sites in Casitas Del Sol, which converted to a resident park about a month ago.

"It is difficult for all 200 mobile home residents to buy their share at one time," Malone said. "(This plan) allows for additional time for the homeowner to come up with the money."

PLANNED DEVELOPMENTS

Vista Del Mar in Vista was developed as an own-your-own park. Residents own their own lots on which they can put the home of their choice. The difference in the development compared to a standard subdivision is that lot owners must live in manufactured homes.

George Lind has lived here since 1983.

"Of the 256 spaces in the park, all but five or six have sold," Lind said of the Vista property. "We have a swimming pool and tennis courts, yet our homeowners dues are $41 per month compared to condo complexes."

Gesturing to the manicured lawns, driveways and the stuccoed buildings, Lind said that most of the homes traveled from the factory along the interstates on flatbed trucks.

"They were put on a permanent foundation and there was never the intent to move them again," he said. Most have two-car garages.

In the first phase, lots sold from $35,000 to $45,000, but now a typical lot can cost between $70,000 and $80,000. Model homes in the development are selling for $157,000 to $175,000, which includes the land. The homes are 1,400 to 1,850-square-feet with cathedral ceilings, fireplaces and wet bars.

"In rental parks, you have a lot of investment in someone else's property," Lind said. "My wife and I were looking for a kind of place without big lots. We have a nice patio where we can do a little gardening. We didn't want to be slaves to the yard. We play tennis and there are tennis courts here. The clubhouse has a fully-equipped kitchen which we can use at no cost. We like the (swimming) pool, but didn't want the cost of maintaining it. When you get to a more mature age, these things appeal."

Shadow Ridge Oaks, another planned manufactured home development in Vista, has four models for sale ranging in price from $149,000 for 1,325-square-feet to $175,000 for 1,600-square-feet. Homeowner association dues are $57 per month at the 136-site development. Amenities include a recreation center with a swimming pool and a Jacuzzi.

"On the dollar per square foot, you're getting more for your money with these manufactured homes," Shadow Ridge resident Sharrie McIntosh said.

She and her husband purchased the 1,935-square-foot manufactured home on a 5,200-square-foot lot for $164,500.

"All the plumbing is under the house. It is insulated well. The heating comes from the bottom so it is not wasted. I would never buy a home on a slab. You go to sell your house and the foundation's cracked. These are built to earthquake standards," she said.

GRAPHIC: Photo, COLOR, COVER STORY: Leading the Good Life in a Mobile Home: Mary Sanelli, left, and Vivian Cohagan wave to a passing friend at the Vista Cascade Mobile Home Park in Vista ; Photo, Life at

Rancho Carlsbad mobile home park: residents sun themselves by the pool; Irv Fishlow tends to his broccoli patch; elegant clubhouse has library, ballroom, lounge. ; Photo, Today, mobile home parks often have neatly manicured lawns and tree-lined streets. DON BOOMER / For The Times; Photo, Mary Sanelli, left, gives Vivian Cohagan a taste of spaghetti sauce. With them is fellow Vista Cascade resident Carol Pollock. ; Photo, Clancy Pollock prepares the Vista Cascade news bulletin. DON BARTLETTI / Los Angeles Times

Evidentiary Exhibit Number 206

The New York Times

February 9, 1991, Saturday, Late Edition - Final

SECTION: Section 1; Page 30; Column 1; Financial Desk

LENGTH: 750 words

HEADLINE: Your Money;

Taxes on Homes Rented Out Briefly

BYLINE: By Jan M. Rosen

BODY:

Despite the depressed real estate market, some homeowners have little choice but to put their homes up for sale. Job relocations as a result of layoffs or transfers force some to move, while for others personal or family situations necessitate a move.

But all too often houses remain unsold for extended periods, and owners decide to rent them until the market improves, said Pamela J. Packard, a certified public accountant in the New York office of BDO Seidman. In this situation, she added, there are important tax considerations for homeowners.

The heart of the matter is that capital gains tax is deferred on the sale of a principal residence only if another principal residence is purchased within 24 months before or after the sale, and if the cost of the new house is at least equal to the selling price of the old house less selling expenses and fix-up costs. But no such tax break is available for investment real estate or second homes.

"So the goal for people who resort to a temporary rental is to preserve the tax-free rollover," Ms. Packard said. "The issue is whether renting the residence changes its character." Because the statutory language is vague, there have been a number of court cases that considered the circumstances of of each case individually.

Some recent court rulings have been favorable to homeowners, she continued, and as a result more people are renting their homes temporarily.

Ms. Packard noted that two key elements in the favorable court decisions were that the rental was temporary and that it was ancillary to an effort tosell the home. That means homeowners must make an honest sales effort. Renting the home now with the plan of listing it for sale later when the market improves will not pass muster.

"A month-to-month lease would be temporary, but it may be questionable whether you are going to get a tenant who would want one or whether you would want that tenant," she said. "A one-year lease is probably O.K." She recommended that homeowners include a provision in the lease allowing them to show the house to prospective buyers in the later months. An extended rental would be unacceptable in any event because the rule that the sale must take place within two years of the purchase of another principal residence is strict.

People over age 55 are allowed a one-time exclusion on capital gains of up to $125,000 on the sale of a principal residence, provided they have lived in the house three of the last five years. For these people, Ms. Packard noted, it is thus imperative that the rental not exceed two years.

To show that the rental is ancillary, she advisedhomeowners to get statements from their real estate brokers that because of market conditions their houses could not be sold at a fair price.

"Once people are receiving rental income, they can shelter it with taxes and mortgage interest," she said, "and if they still have a positive number, they can take normal landlord-type deductions, including insurance, maintenance and depreciation, but it is important not to go negative."

The reason is that losses are deductible only by those in the trade or business of real estate. "You can't argue it from both ends of the spectrum," she said.

"Of course, even in today's market something can be sold if the price is low enough," Ms. Packard added. "But this provides an opportunity to try to see if the market will improve, if you buy into the idea that the recession will be over by summer and interest rates will be lower."

The Tax Bite

The Tax Foundation, a nonprofit Washington-based research organization, says the Bush Administration's budget will cost the typical American family $12,984 in 1991. It says the family, which it describes as having two workers earning $46,000 with two dependent children, will pay $8,314 in direct Federal taxes (individual income and Social Security taxes) and $4,670 in indirect taxes like the employer's share of Social Security, corporate income taxes, excise taxes and miscellaneous levies.

The organization says this makes taxes the biggest item in the family budget, with Federal taxes taking 28.2 cents of every dollar and state and local taxes taking 9 cents. That leaves 62.7 cents for personal use, which gets divided up as follows: housing and household expenses, 20.3 cents; transportation, 13.7 cents; food, 10.9 cents; health, 4.1 cents; recreation, 3.8 cents; clothing, 3.7 cents; insurance and pensions, 2 cents, and all other, 4.3 cents.

GRAPHIC: Drawing

LOAD-DATE: February 9, 1991

Evidentiary Exhibit Number 207

U.S. News & World Report

November 12, 1990

SECTION: BUSINESS; COVER STORY; Vol. 109, No. 19; Pg. 70

LENGTH: 3287 words

HEADLINE: How to think about your home

BYLINE: By Anne Kates Smith

HIGHLIGHT:

The housing market is sickly, but you don't have to wait helplessly for it to bounce back

BODY:

If homeowners feel panicky, it's not without reason. This year and next, home prices nationally won't keep up with inflation, and some areas -- like once unstoppable California -- are bracing for a nasty fall. But experts see prices picking up along with the economy by 1992, while the slump in commercial real estate could linger until 1996 or 1997.

How your home's value will fare depends on your local economy. You needn't bite your nails just because commercial builders are going bust -- unless, perhaps, you're an early resident of a half-finished subdivision where all work has stopped. You may even benefit. The fewer homes built, the more yours will be worth. Less mortgage money for developers means more for home loans, though qualifying will be tougher. Here are answers to questions owners, buyers and sellers might ask the experts.

HOMEOWNERS

I can't help thinking of my home as an investment. What return can I expect?

You can forget the double-digit gains of the '70s and the '80s, when inflation, nesting baby-boomers and speculative fever sent home prices soaring. For the next two years, you may actually lose ground, since prices nationally are expected to lag the inflation rate; in many areas, values will fall. But prices should beat inflation by a point or two during the rest of the '90s, rising an average 5 to 5.5 percent a year, predicts the WEFA Group, an economic-forecasting firm.

That much appreciation can still make a home a good long-term investment because of the benefits of leverage. Someone who puts $ 20,000 down on a $ 100,000 house and sells a year later for $ 105,000 -- a 5 percent gain -- has a 25 percent return, figured simply. Anthony Downs of the Brookings Institution in Washington, D.C., calculates that if prices rise just 4 percent a year, a homeowner who put 20 percent down and has a 10 percent mortgage would earn 10.3 percent annually over 10 years, about the long-term return for stocks. But WEFA projects that only 12 of 50 major metro markets can expect that kind of appreciation in 1990, including some still-hot Western cities like Portland and some comeback cities like Houston in the Southwest. Only three markets will fare so well in 1991: Washington, D.C., Norfolk, Va., and Fort Lauderdale, Fla.

Need I worry about slumps in distant markets?

No. You may not even have to worry about what's happening across town. Real-estate markets depend on local economies and on local supply and demand. In northern New Jersey, hit hard by the slump in the financial-services industry that followed the 1987 stock-market crash, WEFA expects prices to fall nearly 8 percent this year. By contrast, Chicago prices, which weren't sent to the stratosphere during the '80s boom, should rise nearly 9 percent. Within one metropolitan area, the outlook can vary by neighborhood. Take the

Boston area, where gains of 30 percent or more in 1985 have turned into losses. Houses in the $ 200,000-$ 300,000 range in towns like Malden and Medford have held declines to 7 to 10 percent in the last 12 months, says real-estate agent Joseph Delaney, since little in that price range was built in the '80s. In nearby Weston and Wayland, where builders rushed to put up $ 400,000-$ 500,000 homes, a slowdown in demand has pushed prices down 10 to 20 percent.

There's lots of gloom-and-doom talk about my local market. How can I accurately gauge market conditions before I sell?

By relying on statistics rather than gossip. Besides looking at the median sale price in your area compared with a year earlier, you'll want to know the number of sales, how long houses sit on the market and the difference between the listing and selling prices then and now. Because home sales are seasonal, you needn't bother with month-ago or quarter-ago comparisons. The numbers are published by most local real-estate boards or are available from a real-estate firm in your area.

Is this a good time to line up a home-equity loan?

People often arrange these once cheap loans just to have cash handy. Unless you need the money, think twice. Rates have been stable at around 12 percent, but few lenders now forgo fees. Application fees of $ 100 to $ 400 are common, as are points -- charges equal to 1 percent of the loan.

BUYERS

I've been trying to break into the housing market for years. Is this my chance?

This is it. First-time buyers, who normally account for 30 percent of existing home sales, now are involved in about 40 percent of deals. Some lenders are even targeting first-time buyers with special money-saving programs. Dime Savings Bank of New York, for example, is offering 100 percent financing for buyers who get a parent or employer to buy a certificate of deposit worth 20 percent of the home price. The CD, with a current 12-month yield of 7.95 percent, would stay on deposit until the loan value fell to 80 percent, which could take 10 to 12 years.

I want to buy at the right time. Can I tell when the market has bottomed out?

You can never know for sure until prices head up, but the bottom is near when price cutting is widespread. Two signs that your market is poised for recovery are falling interest rates and local-employment growth. The number of homes sold will turn up before prices do. That will signal a buying opportunity that could last 12 to 18 months before bargains vanish.

SELLERS

Since nothing is moving in my neighborhood, how can I set a realistic price?

It may be worth hiring an appraiser, who can look at land values, building costs and rents in your area as well as comparable sales. An appraisal runs about $ 200-$ 250 for a written report. You might be able to get an appraisal minus the details of a written report for 50 percent less. The abbreviated version might omit some of the measurements, diagrams and detailed descriptions of the house and the neighborhood that you really won't need.

Are there secrets to selling in a down market?

A realistic price is the key. This is the worst time to start high, planning to lower your price during the negotiations. Asking 105 percent of the appraised price is reasonable. To snag a buyer who still wants to haggle or who needs help swinging the deal, you might consider providing part of the financing rather than lowering the price. One inexpensive way is to partly subsidize the interest rate on a buyer's mortgage for the first couple

of years. By putting just $ 2,600 in an escrow account, for example, you can lower the 10 percent rate on a $ 100,000 mortgage to 8 percent in the first year of a 30-year loan and 9 percent in the second year. Instead of owing $ 878 a month right away, the buyer pays $ 734 a month the first year, $ 805 a month the next.
We're retiring in a few years and are concerned about losing the savings tied up in our home. Should we sell now?

Not unless you're forced to. Prices could bounce back before you suffer what is now only a loss on paper. Besides, people who have owned their homes longer than the past few years can probably rest assured that their nest eggs are still intact. Even in Houston, where prices plunged in the '80s, people who owned an average home from 1974 to 1989 saw their inflation-adjusted equity increase by 8 percent annually, partly from paying down the mortgage and partly from appreciation.
MOVING UP

We're ready to trade up. What's the best strategy?

Trade-up buyers are in a good position in many markets. Their moderately priced homes might not command peak prices, but at least they're selling, while the more luxurious homes these buyers are interested in are languishing on the market. Trading up works best if you sell first, then buy. You'll be under much pressure to accept a lowball offer if you're strapped by a bridge loan, a short-term loan, backed by the equity in the old house, that pays the mortgage on the new house. You also lose bargaining power as a buyer when your offer is contingent on selling your old house. Better to bid on a new house after you've collected a buyer's earnest money on your old home and make your offer contingent on the closing of the sale.
VACATION PROPERTY

Is this a good time to look for a vacation home? Where are the best deals?

You can find bargains in resort areas now, but you're probably not going to get rich investing in vacation property. Playgrounds that provide the best value are those that will attract retirees as well as vacationers and where prices have either been beaten down in concert with nearby housing markets or haven't seen the run-ups enjoyed by more-popular resorts. They include Padre Island, Tex., where vacation homes are lagging the real-estate comeback in Houston and Dallas; Traverse City, Mich., where golf courses are luring retirees, and Big Sky, Mont., where the cost of skiing, golfing and lakeside life hasn't yet skyrocketed as it has at other Northwestern resorts.
GETTING A MORTGAGE

Will the squeeze on commercial credit restrict funds available for home mortgages?

Just the opposite. While lenders are turning away developers, most welcome borrowers for homes. Home loans have historically been low-risk; late payments, while expected to rise, should remain below 1985's peak. Moreover, the number of mortgage lenders still reflects the boom times, even though demand for mortgage money has slackened with the economy. It's not uncommon for lenders to make house calls to snag customers, taking applications in their living rooms.
Has it gotten harder to qualify for a loan? What can I do?

Officially, it hasn't gotten harder. But while lenders are eager to make home loans, they're not anxious to take risks with a recession coming on. A late payment or two in your credit report that might not have mattered last year may trip you up now. Lenders also will verify your income and employment history more rigorously. To better your chances, make sure your credit report is as clean as possible and pare debt. You might jettison unneeded credit cards, so you're not penalized for credit that's available to you.

Where will I find the best deal?

A mortgage banker, whose sole business is making and servicing mortgage loans, will likely be your best bet, by a nose. A survey last month by mortgage trackers HSH Associates found mortgage bankers offering 30-year fixed loans at an effective rate of 10.32 percent, including points and fees, vs. 10.43 percent at banks and 10.44 percent at savings and loans. Mortgage bankers' one-year ARM's, at an average 8.23 percent effective rate, won out, too.

RENTING

I'm looking for a new place to live. Should I rent?

If homes are appreciating 5 percent a year or more, you'll probably do better owning. But your decision depends on such variables as rents and expected appreciation in your area, mortgage rates, closing costs, taxes, rates on alternative investments and how long you expect to stay in a house. The Real Estate Center at Texas A&M University has developed a software program that will crunch the numbers. The $ 20 Residential Buy-Rent Software Package is available for IBM and compatible computers. Contact Director, Real Estate Center, Texas A&M University, College Station, Texas 77843, (409) 845-2031.

This is a great time to buy in my market but not to sell. Should I rent my house and buy a new one?

First there's the hurdle of the down payment on the new home. A home-equity loan on your old home might cover it, but lenders often stipulate that borrowers must live in the home backing an equity loan. Even if you manage to sell a lender on the deal, you may not be able to deduct all of the interest on the loan, as you could on a regular home-equity loan. The IRS is working on a ruling now to determine how much home-equity-loan interest is deductible when the loan is backed by a rental property.

Most people who decide to rent out their old home will depend on rental income to show they can afford the mortgage on the new house. But lenders typically credit only 70 percent of the rental income, leaving the rest to cover repairs, maintenance and vacancies. Unless you rent out the old place for less than two years and can convince the IRS that you're diligently trying to sell it, you'll also lose the right to roll over any capital gain you eventually earn when you sell the rental property. On the other hand, as a landlord, you'll enjoy tax breaks like deductions for repairs and insurance, agent fees and depreciation as well as for mortgage interest and property taxes.

REMODELING

Maybe I should stay put and remodel. What factors should I consider?

Builders are clamoring for work, so you probably won't have to wait long for a contractor; in some markets, prices are coming down. But bargain hunters should be careful about whom they hire, since many freelance carpenters and construction workers laid off from other jobs are also looking for remodeling work. They probably won't have the workers' compensation or general liability insurance carried by professional builders, which means you or your homeowner's insurance will have to cover any injury on the job or damage to your home. If a problem with the work crops up later, many workers won't be around to fix it, having returned to their regular trades.

DESPERATION MOVES

I'll try anything to sell at this point. Suggestions?

Beyond a few strokes with the markdown pen, you might throw in a free vacation or the family car. Century 21 broker Susan Blinkhorn hired a psychic for $ 125 an hour to lure agents curious about their fortunes to a house in North Potomac, Md.really a place. Some sellers swear that burying a statue of St. Joseph, the patron

saint of families, will unearth buyers. Jackie Anderson's house in Garden Grove, Calif., went unsold for 3 1/2 months until she bought a St. Joseph statue for $ 1.50. Eight days later, Anderson had a buyer.

STARTER HOMES:

In most markets this year, homes for sale wait longer for buyers. Lower-priced homes have moved faster than deluxe dwellings.

Days on Change in
market, days, since
Price range 1990 1989

EAST
Boston $ 110,000-155,000 90-105 +15
Philadelphia 60,000-85,000 110-125 +25
New York City 140,000-175,000 145-160 +30
Rochester 50,000-75,000 45-60 +5

SOUTH
Atlanta $ 65,000-80,000 85-100 +35
Houston 40,000-70,000 55-70 -60
Miami 70,000-90,000 55-70 +30

MIDWEST
Chicago $ 65,000-85,000 30-45 +5
Cleveland 50,000-80,000 70-85 -10
Indianapolis 55,000-85,000 75-90 +20
St Louis 50,000-65,000 50-65 +10

WEST
Denver $ 50,000-65,000 90-105 +5
Los Angeles 200,000-250,000 160-175 +75
Sacramento 95,000-125,000 60-75 +60
USN&WR-Basic data: Century 21 Real Estate Corporation

TRADE -- UP HOMES:

Fearful of buying one house before they've sold another, many people who would like to trade up are holding off for now.

Days on Changes in
market, days since
Price range 1990 1989

EAST
Boston $ 185,000-265,000 100-115 +20
Philadelphia 125,000-150,000 110-125 +20
New York City 275,000-350,000 145-160 +25
Rochester 80,000-120,000 40-55 +5

SOUTH
Atlanta $ 110,000-125,000 110-125 +25
Houston 90,000-130,000 80-95 -95
Miami 95,000-130,000 55-70 +15

MIDWEST
Chicago $ 125,000-170,000 45-60 +5
Cleveland 125,000-175,000 95-110 -20
Indianapolis 90,000-150,000 90-105 +40
St. Louis 95,000-135,000 60-75 +15

WEST
Denver $ 85,000-125,000 90-105 -20
Los Angeles 300,000-400,000 160-175 +85
Sacramento 175,000-250,000 90-105 +90
USN&WR-Basic data: Century 21 Real Estate Corporation
EXECUTIVE HOMES:
Expensive homes are going begging this year, as many markets struggle to digest leftovers from the 1980s building binge.
Days on Change in
market, days since
Price range 1990 1989
EAST
Boston $ 300,000-700,000 240-255 +90
Philadelphia 175,000-375,000 110-125 +25
New York City 500,000-700,000 150-165 +20
Rochester 150,000-375,000 50-65 +5

SOUTH
Atlanta $ 225,000-400,000 175-190 +65
Houston 150,000-400,000 175-190 -50
Miami 225,000-475,000 125-140 +70

MIDWEST
Chicago $ 250,000-450,000 65-80 +15
Cleveland 225,000-400,000 115-130 +25
Indianapolis 200,000-400,000 150-165 +40
St. Louis 195,000-350,000 75-90 +25

WEST
Denver $ 140,000-325,000 105-120 +10
Los Angeles 400,000-750,000 195-210 +120
Sacramento 300,000-600,000 175,190 +160
USN&WR-Basic data: Century 21 Real Estate Corporation

GRAPHIC: Drawings: No captions, David S. Merrill; Chart, Starter homes, USN&WR-Basic data: Century 21 Real Estate Corporation; Chart, Trade-up homes, USN&WR-Basic data: 21 Real Estate Corporation; Chart, Executive homes, USN&WR-Basic data: Century 21 Real Estate Corporation

Evidentiary Exhibit Number 208

Business Dateline;
Tulsa Business Chronicle
August 13, 1990

SECTION: Vol 9; No 33; Sec 1; pg 9
LENGTH: 787 words
HEADLINE: Housing Rental Market Picking Up, Realtors Say
BYLINE: Chris Downs Riddle
DATELINE: Tulsa; OK; US
BODY:

The single-family house rental market is tightening in Tulsa, causing rents to go up, local Realtors say.

Exact numbers are hard to determine, however, since this part of the market is not tracked statistically.

Jay Menger, owner of J. Menger Realtors, says that unlike the home-sales market -- where there are services that list salable properties -- there is no such clearing house for single-family rentals in Tulsa.

There are a few rental agencies and locator services, but they don't exchange much information, Menger says.

Landlords and rental homeowners often are aware of what's happening in other parts of their market because they don't have access to data, he says.

"In the housing market, if I own two or three rental houses and don't have any turnover in a year or so, I may not be aware of what's going on until I run an ad in the paper," Menger says.

"If I've got 20 people calling me instead of the three or four before, and if I'm alert, I may pick up on that and decide I can charge more for rent."

This factor also makes it difficult for someone seeking a house to rent to find a complete source on what's available, he says.

Menger says that although his firm doesn't handle rentals, he gets a feel for the market by the number of people who call him daily inquiring about single-family rental properties.

"Hardly a day goes buy that somebody doesn't ask if we've got something to rent, or ask about one of the houses that we have for sale, just to inquire about whether the owners would consider renting it," he says.

This local increase in rental demand should bode well for the residential sales market, Menger says.

"If things keep going in this direction, it should have a positive effect."

Betty Sample, owner of Taylor Sample & Coppedge Locating Service Inc. in Tulsa, maintains the rental market here is good and will continue on an upward trend at least as long as people continue to move into the city.

"I think the economy is getting better. We've had a lot of new people move into town," says Sample, whose firm specializes in locating, renting and managing apartments, condominiums and homes.

Sample says that normally there are higher home vacancies in the spring and summer months, creating opportunities for renters -- but not this year.

"We are leasing things as fast as we can get them," she says.

Sample says the tight market could be caused by several factors.

Higher residential sales, an increase in population and a low turnover rate for rental houses could result in a tighter, stronger rental market, she says.

According to Sample, people rent homes as opposed to buying homes for several reasons.

She says many times people come to town on a one- or two-year contract, and fear an investment in a home might be risky. Others who move here have homes that haven't sold in other cities, so they are unable to buy yet, she says.

Still others prefer to lease for a while to shop the market and get to know the areas in which they'd like to live, she says.

Cindi Ramsey, manager of John Hausam Realtors' leasing department, says she's seen the market tighten up in the last year to 16 months.

Ramsey surveyed about 1,000 landlords in the Tulsa area who indicated that the vacancy time between renters, compared with what it was like two years ago, has decreased.

Twenty of those interviewed represented 500 rental properties, excluding apartments, she says.

"The majority of them are having two weeks or less vacancy time," she says.

In addition, many of the landlords have been able to increase rental rates by 5 percent to 10 percent, Ramsey says.

She said the most popular price range for a home right now is between $ 500 and $ 700 per month. Although the more expensive homes are being leased, it's almost impossible to find one in the mid-price range.

A few years ago, a potential renter could lease a house for about $ 400 per month, she says.

"But, it's very difficult now to find a nice home now for less than $ 450."

Ramsey says because there are so many homes for sale on the market, buyers become confused and therefore, rental units grow more attractive.

"I'm hoping that these people that we are renting (homes to) will turn into buyers in a year, so that the sales market will turn around," she says.

Jess Youngblood, president of Detrick Hughes & Jones Realtors, says the rental business is good right now.

He says that because so many people have inquired about rental houses, -- at least five or six a week -- the firm is planning to institute a department specializing in leasing or rental of single family residences.

Up until now, Detrick Hughes & Jones has delt only with the single-family sales end of the market.

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LOAD-DATE: October 15, 1995

Evidentiary Exhibit Number 209

The Washington Post

August 4, 1990, Saturday, Final Edition

SECTION: REAL ESTATE; PAGE F2; HOUSING COUNSEL

LENGTH: 660 words

HEADLINE: Tax Benefits of Rollover Hinge on Timing of Sale

SERIES: Occasional

BYLINE: By Benny L. Kass

BODY:

Q. I have been trying to sell my condominium unit for some time. The market is poor, and I have had no success. However, we recently purchased a new house, and we must shortly move into that home.

If I cannot sell the condominium, I intend to rent it until it is sold. Is there any problem with this arrangement with regard to not paying tax on capital gains for the condominium? I have bought a house which costs more than the condominium, and I do not intend to depreciate the condominium for tax purposes, as well as declaring rental income. Please advise.

A. The rollover benefits under the tax laws are mandatory. No more than two years can elapse between the time you buy your new property and sell your old one. It is possible to take advantage of the rollover if, for example, you buy your new house this month, rent out your old one for a period of time, but sell it no later than August 1992. Conversely, you can sell your condominium in August 1992, and you have two years in which to buy another property.

If you put your current house on the rental market, the tax laws will continue to protect you only if you have made a good-faith effort to sell your house first, but without success. Obviously, you meet that test. But the mandatory two-year requirement cannot be waived.

Keep in mind that when you rent out your house, you no doubt will take a tenant for at least a year. That will give you only one additional year in which to sell your house. Most people do not want to buy a house that is tenant-occupied, so if you extend a one-year lease for another year, you might have problems marketing the condominium.

Thus, the timing and the logistics of this transaction are quite important.

Additionally, although you did not indicate your age, you can also take advantage of the once-in-a-lifetime $ 125,000 exemption, if you have lived in your condominium three out of the last five years and are older than 55. In other words, if you have lived in the house for three years, and now you rent it out, as long as you sell the property by August 1992 you are entitled to take advantage of the once-in-a-lifetime exemption.

You certainly have the right to couple the rollover with the once-in-a-lifetime exemption.

However, keep in mind that you may not want to use up the once-in-a-lifetime exemption, because as the name suggests, you only can take it once. It may very well be that the new home will appreciate faster than your old one, in which case you may not want to consider ignoring the once-in-a-lifetime exemption on your condominium and taking it instead on the new property when you ultimately sell that one.

There is one additional aspect to be considered, and that is the availability of the like-kind exchange. If, for example, you rent your condominium and more than two years have elapsed, the condominium is now

considered investment property, rather than your principal residence. Under this approach, you can no longer take either the once-in-a-lifetime exemption or the rollover.

However, now that the property is investment property, you have the right, under Section 1031 of the Internal Revenue Code, to use the so-called "Tax Free Exchange." Under this scenario, when you decide to sell the condominium, you can exchange it for another investment property, and this will accomplish the same results as if you took the rollover.

In other words, a like-kind exchange defers tax and gives you the opportunity to use more money, such as the tax savings, to invest in additional investment property.

These issues often are complex, and you must discuss your particular situation with your individual tax advisers.

Benny L. Kass is a Washington attorney. For a free copy of the booklet "A Guide to Settlement on Your New Home," send a self-addressed stamped envelope to Benny L. Kass, Suite 1100, 1050 17th St. NW, Washington, D.C. 20036. Readers also may send questions to him at that address.

Evidentiary Exhibit Number 210

ASAP

Real Estate Today

August, 1990

SECTION: Vol. 23 ; No. 7 ; Pg. 38; ISSN: 0034-0804

LENGTH: 3133 words

HEADLINE: Help plan a marriage of convenience; unite buyers and investors through equity sharing; includes equity-sharing transaction negotiation points

BYLINE: Dopp, Carylon

BODY:

Help Plan a Marriage of Convenience

In rapidly appreciating markets, the only way many young people can buy their first house is to ask their parents for the down payment. But that may very likely be money their parents have been saving to enjoy during their retirement. Not that parents aren't usually willing to make the sacrifice, mind you. But wouldn't it be better if you could structure sales so that both the children and the parents would benefit from the purchase?

You can--with equity sharing. Some people may think equity sharing makes sense only in a hot market. But the truth is that it can make sense in any market as a long-term investment. Regardless of your current market conditions, you should know about this option.

Equity sharing is an arrangement whereby a buyer agrees to share part of the anticipated appreciation in a home with an investor who puts up mos t or all of the down payment. Any time after an agreed-on minimum period--often three to five years--either party can make the decision to cash out.

At that time, one of three things may occur. The house may be sold and the appreciation split according to the agreed-on formula. Or the buyer or the investor may buy out the other and refinance the property at its newly appreciated value. Finally, the buyer and the investor may decide to extend the contract. In fact, our contract specifies that at the end of the agreement period, the contract stays in force if neither party notifies the other of a desire to sell.

You've probably already handled similar situations. Think of the last time you worked with first-time buyers who needed help from their family to close the transaction. To the equation add investors you've helped find properties with no negative cash flow, and you have the makings of an equity-sharing contract. You can come up with an arrangement that serves both parties and earns you a commission--and perhaps a counseling fee.

The Rewards--and Risks

Some immediate benefits can be gained through equity sharing. The buyers need substantially less money to get into the property. And as soon as they close, they start to profit from income tax deductions. Over the length of the contract, they'll enjoy the satisfaction of home ownership and watch their profits from appreciation grow.

When the contract ends and they agree to sell the property, they can roll over their profits by using an Internal Revenue Code (IRC) Section 1034 rollover. This 1034 rollover allows them to invest their profits in a

home of equal or greater value within two years without paying capital gains tax on the profits. At that point, they may be more financially able to buy a home on their own--without an investor's help.

It's clear how equity sharing can benefit a buyer, but why would an investor select equity sharing? In the 1970s and early 1980s many investors had become involved in partnerships to build their real estate holdings. But the Tax Reform Act of 1986 made partnership less attractive. so investors began to look at IRC Section 280A, which provides guidance on handling the tax benefits or burdens of equity sharing.

As of February 1990 there hadn't been any approved regulations or test cases of IRC 280A. But as the law now stands, equity sharing provides some impressive benefits for investors. Not only do they get a highly leveraged, secured investment, but they also have tax write-offs, capital gains deferral, and potentially no negative cash flow.

If the investors have owned rental properties before, they may appreciate tenants whose interest in maintaining and enhancing the property's value equals their own. When the contract has ended, the investors can reinvest their proceeds through an IRC Section 1031 tax-deferred exchange. That way they can maximize their investment growth and protect their estate for their heirs.

To ensure that the IRS will allow the exchange, investors should treat the property as they would any other real estate investment and comply with the requirements of the 1031 exchange. They should deposit their portion of the gain with a facilitator of 1031 exchanges until they find a suitable replacement property. Then, within 180 days of the sale, they must buy a replacement property of equal or greater value than their portion of the investment property they sold. The replacement property must also increase their debt load. In other words, if they owned 60 percent of a property with a $ 100,000 mortgage, their next mortgage would have to be greater than the remaining balance of their $ 60,000 share of the mortgage on the "shared" property.

Finalyy, in areas with good appreciation, equity sharing can be a boon for retirement planning, since investors may be able to earn more on their investment through equity sharing than on more traditional secured investments.

Keep in mind, though, that healthy appreciation doesn't come without risk. If the market flattens, the buyers and investors may have to hang on several years before they see a return on their investment. Although the contract specifies a certain term, the buyers and investors may agree to keep the contract valid until the market picks up. But what if one party insists on selling after the term expires? That could result in a less-than-stellar gain on the initial investment. There's also a chance, however slight, that one party will default on the agreement.

All in the Family

When you're looking for investors, family members certainly aren't your only source, but they may be the most obvious. Keep in mind that dealing with family investors shouldn'd turn the arrangement into an informal agreement. As non-family investors require a contract before entering into an equity-sharing agreement, so, too, should family members. But relatives often go into such joint investments with only a handshake to remember the terms by. And their memories have been known to change over time.

For instance, I recently heard of a situation in which parents and children had resorted to talking only through an attorney. The parents had lent their daughter and her husband money for a down layment. Later, when the couple sold the house for a hefty profit, the parents believed they deserved some of the appreciation. However, the children insisted on paying only the loan plus interest. Meanwhile, $ 100,000 sat in an escrow account until the conflict was resolved.

This example shows that an equity-sharing contract can be beneficial when family relationships are involved. Family members are less likely to quarrel later if they've negotiated the terms of their arrangement up front and signed a contract. And they may be more willing t put up the money in the first place if they know they may get back more than just the principal and interest. Finally, the tax benefits they'll get from an equity-sharing investment aren't available with a simple loan. In fact, they'll end up paying taxes on the interest they make on the loan, something they can avoid through equity sharing.

Equity sharing may allow relatives to set a schedule for helping another family member each time a contract is completed.

Equity Sharing Stacks Up

Whether the investors are family members or not, they may be interested in seeing the return they'll get with equity sharing compared with other investments. You can show both the investors and the buyers that equity sharing stacks up pretty well in an appreciating market.

In the fourth quarter of 1989, 75 of 83 metropolitan statistical areas tracked by the National Association showed an appreciation in value. Although the national median was 4.6 percent, some areas showed a much more dramatic increase. The hottest market in the country was Seattle-Tacoma, with 25.2 percent appreciation.

The exhibit, "Equity Sharing: They'll Love It," gives a breakdown of what buyers and investors could expect to realize in a three-year equity-sharing arrangement. To simplify the exhibit, the rise in appreciation is presented as stable for three years. And selling costs aren't included. Also, the figures don't take into account the tax benefits accrued during the three years.

If both parties had put their initial investment in a certificate of deposit paying 8 percent, the buyer would have ended up with only $ 8,025 at the end of three years, and the investor would have ended up with $ 21,162. Neither would have had any tax benefits, and, in fact, they might have incurred a tax liability.

Another plus for investors is that as of January 1, 1989, Fannie Mae raised the down payment requirement for investment housing to 30 percent, effectively reducing investors' leverage. As the exhibit shows, the investor was able to put down half of what he would have been required to invest if he had bought the house on his own. And for half the money, he's receiving 60 percent of the home's appreciation.

Turn Problems Around

With equity sharing, you can branch out in ways you may never have considered before. Most important, you'll be able to sell more by better serving first-time buyers, particularly those who could't otherwise buy a home. And happy buyers are more likely to return to you for their next home or investment property--and their next. In addition, the buyers and investors you pair up will be a continuing source of referrals.

You can also provide a new option to coples who are getting a divorce. Often, one partner wants to sell the house, take the money, and run. But the other wants to stay in the house until the children finish school. By using equity sharing, you can make it possible for both to achieve their goals. An investor buys out the interests of the departing spouse, allowing the remaining spouse to stay in the home and benefit from continuing equity appreciation.

Also, don't overlook the possibility of working with employers who might benefit from equity sharing. Employers may offer to act as investors in equity-sharing arrangements with employees to

* Attract those who would turn down employment because of housing costs

* Retain those who might seek jobs in areas with more affordable housing

* Create a type of retirement benefit

* Give a bonus to those who have proved valuable

Offering employers the opportunity to act as investors lrovides you with two marketing options. If youalready work with companies to help relocate their incoming employees, you now have an additional benefit you can offer them. If you want to convince companies you don't currently work with to refer transferring employees to you, you can use the possibility of equity sharing to make yourself stand out from other agents who have approaced them. But since most relocation companies will want a written agreement, you may have to look to your broker to make such arrangements.

Finally, don't overlook the possibility of becoming the investor yourself. When you have motivated, qualified buyers who lack the down payment they need, equity sharing can benefit both of you. If you do choose to be the investor, be scrupulously ethical about disclosing pertinent facts, including that you're the agent working on your own behalf. Be careful to comply with the agency guidelines in your state, particularly when you're working with your own listings.

Writing Up the Contract

Parties in equity-sharing arrangements may choose to hold title as joint tenants. Each party then has an equal interest in the property. This may seem like a sensible arrangement, but it's not.

Tenancy in common receives the best tax treatment under IRC 280A. I recommend that when writing the equity-sharing contract, you set up a tenancy-in-common agreement to ensure that both parties are eligible to take a tax-deferred gain.

With tenancy in common, the parties may hold unequal interests, and each party may hold title differently. For example, Mr. and Mrs. Buyer may hold an undivided 40 percent share of the residence as community property. Mr. Investor may hold his undivided 60 percent share of the property as the sole and separate owner. "Undivided" simply means the property can't be divided up physically on the basis of the percentage of ownership. For example, the investor can't say, "It's a 1,000-square-foot house, and the first 600 square fee are mine."

Under joint tenancy, if either party dies, the property goes to the surviving party. But under tenancy in common, the deceased party's portion of the property would go to that party's estate.

Sign on the Dotted Line

To qualify as equity sharing and received the tax benefits accorded under IRC 280A, the arrangement split, though it might not be in their best financial interest. Although most family members don't enter such an arrangement purely for profit, they should look at the agreement as a business transaction. And savvy investors will want to maximize their profits in such a transaction. If they get greedy, though, it reduces the buyers' incentive to join in.

In general, I suggest that the investor put in 75 percent of the down payment and the buyer 25 percent, with each paying a proportional share of the closing costs. With a 20 percent down payment, the buyer is putting down 5 percent and the investor 20 percent. At least a 5 percent down payment by the buyer is usually critical to getting the loan approved. Any less would very likely make the loan too risky for secondary market investors.

That doesn't mean the ownership split should automatically be 75/25 to coincide with the down payment. Say you're selling a $ 100,000 house. A 20 percent down payment would require $ 5,000 from the buyers and $ 15,000 from the investors. Assuming that the buyers make all the mortgage payments over a three-year contract, the value to the buyers could be an additional $ 5,000 because, with a 15 percent down payment, the investors generally wouldn't get the amount of their mortgage, insurance, and tax payments back in rent. So in figuring the buyers' share of ownership, you should take into account the potential negative cash flow the investors would incur over the life of the contract if they rented out the property.

Now the total investment over the length of the contract is $ 10,000 for the buyer and $ 15,000 for the investor. In this case an equitable ownership split could be 40/60. Other factors may also need to be taken into account, especially if major repairs or renovations will be made to the property. Estimated values for a new roof, heating system, paint job, and so on, should be included in the equation on the side of the party responsible for them.

Uncle Sam Is Watching

Since both parties will want to maximize the tax benefits they'll get from equity sharing, the contract must include a clause charging the resident buyers a fair market value rent for the share of the property the investors own. The investors then use that rent to pay their share of the mortgage. The tax benefits may be shared according to the ownership share or disproportionately as negotiated in the contract.

To satisfy the IRS, the parties must create a paper trail, or the investors may lose their depreciation benefits. I advise buyers to open a collection account with a local bank or to hire an accounting firm to handle the payments. The buyers then write two checks each month--one for the rent and the other for their share of the mortgage. The bank or accounting firm then writes one check to pay the mortgage.

Lenders who haven't had experience with equity sharing may need your help in dealing with these arrangements. In my experience, most lenders will consider properties bought through equity-sharing arrangements as owner occupied when they write the mortgage. They'll want to check the investors' credit and the source of their down payment, but the investors won't need to meet the lender's qualifying ratios.

Although in most equity-sharing arrangements the buyers don't supply a major portion of the down payment, they usually need to qualify for the mortgage as would any other buyers. That means you should prequalify resident buyers as carefully s you would any other buyer. Equity sharing is only for committed and qualified buyers. Unreliable buyers can cause problems for lenders and investors and will reflect poorly on you.

In addition to the equity ownership arrangement, there's a second type of arrangement, called a shared appreciation mortgage nSAM). A SAM can originate in two ways. The seller can agree to carry back a mortgage with a loan rate reduction for a percentage of the profits acquired through property appreciation. Or a financial institution can offer an initial lower interest rate to help a buyer qualify in exchange for oa share of the appreciation when the buyer sells or refinances the property. These techniques can also be used with deeds of trusts.

There are major differences in the way equity sharing and SAMs are handled for tax purposes. It's important to take great care with SAM contracts so that they're truly equity arrangements, or they'll be construed as loans. If the IRS considers them to be loans, it eliminates the parties' ability to use IRC 1031 and 1034 exchanges with their proceeds from the transaction.

Expand Your Services

As a real estate professional, you're in a unique position to accommodate the needs of buyers and investors. But because equity sharing is a complicated tool, it's not something that should be done by novices. Before you do your first such transaction, get help from equity-sharing specialists. You can expand your level of service as you learn more about equity sharing through educatioal classes, books and articles, and consultation with other professionals in real estate, law, and finance.

Eventually, you'll be able to

* Counsel people about how equity sharing could benefit them

* Match up investors and buyers

* Act as a referral source (or recipient) for buyers with special needs who may be good candidates for equity sharing

* Mediate equity-sharing contract negotiations

The service that you offer can be a source of income--aside from the commission generated directly by real estate sales. When I provide accommodation services, I negotiate a fee. It's generally tied to the sales price and divided between the parties at a ratio they negotiate. You'll set your own fees, depending on your level of expertise and the services you supply.

If you know enough about equity sharing to make it work, you'll be able to use it to help buyers, provide investors with excellen investment opportunities, and build your business or your own investment portfolio. Equity sharing can be the technique you use to make yourself stand kut professionally and profitably.
GRAPHIC: Photograph; Table; Equity-sharing - national median and Seattle-Tacoma. (table)
SIC: 6531 Real estate agents and managers ; 6160 Mortgage Bankers and Brokers ; 6500 REAL ESTATE
IAC-NUMBER: IAC 09285701
IAC-CLASS: Magazine; Trade & Industry
LOAD-DATE: August 18, 1995

Evidentiary Exhibit Number 211

Los Angeles Times

July 29, 1990, Sunday, Home Edition

SECTION: Real Estate; Part K; Page 15; Column 1; Real Estate Desk
LENGTH: 1347 words
HEADLINE: THE SMALL INVESTOR: DON'T CARRY NON-PAYING TENANTS
BYLINE: By Special to The Times
BODY:

QUESTION: I own a small neighborhood shopping center. One of my tenants, a coffee shop, got behind about six months in rent. When I started eviction, the owner filed bankruptcy on me.

After delay after delay the tenant finally moved out and left owing me 11 months of rent, and I probably won't get a dollar from the bankruptcy court. I just thought your readers who own rental property should know it doesn't pay to be nice to tenants because they will take advantage of you like mine did.

ANSWER: I also have learned the hard way that it doesn't pay to be nice to tenants who can't pay their rent. The most I let a tenant get behind in rent is 30 days, but usually I begin eviction within 15 days after the rent was due.

Don't Buy Property on Gross Multiplier Basis

Q: I haven't bought an apartment building in at least five years. But last week a real estate agent who sold me a building years ago phoned to tell me about a new listing next door to my apartment building. She said the property is for sale at 8.5 times gross income. Is that a good deal?

A: I don't know. Forget you ever heard those dirty words *gross multiplier.* The building is priced at 8.5 times its gross rental income. But the flaw is the gross multiplier doesn't consider the property expenses.

To illustrate, two identical buildings with identical rental income could be priced at 8.5 times the gross rent. However, if one has individual utility meters, but the landlord pays the utilities at the other building, the one where the tenants pay the utilities is obviously the better buy.

Never use the gross multiplier. Instead, buy income property based on its net income. Use the "cap rate" method which capitalizes a building's net income. The local cap rate is determined by recent sales prices of similar nearby buildings.

Free Management Not Worth Eventual Cost

Q: I own several large apartment buildings. Last week I received a letter from a property management company offering to manage my property for free.

The letter said the management company does not charge to collect rents, but does charge a leasing fee when an apartment becomes vacant. Also, the management company wants the listing if I decide to sell the property. What do you think of an arrangement like this?

A: Not much. I'm sure you will get your money's worth from the so-called free property management. It is very obvious the management company will earn its profits from the leasing fees and from the sales commission if you decide to sell.

To check out this firm, ask for names of three of its current clients and phone those people to ask if they are satisfied with the company and if they have any complaints.

Delayed Exchange Ideal for This Swap

Q: I own about a dozen small residential properties, mostly four units each. They are a pain to manage. But I have more than $1 million equity in them. It occurred to me I should combine them into one large property which can have a resident manager. Can I do this in a tax-deferred exchange?

A: Yes. You can make tax-deferred exchanges of your properties for one large one. This is an ideal situation for a Starker delayed exchange, authorized by IRC 1031(a)(3), since it is unlikely that you can make a direct trade for a large building.

Don't Make Offer Unless Serious Buyer

Q: There is a vacant old house near where I live. It is on a large corner lot, which is suitable for a convenience grocery store. I made an offer to buy this property and the seller accepted.

But I only put up a $1,000 earnest money deposit with a 180-day closing period. Do you think I can get out of this deal, since it doesn't look so good after I investigated the costs and problems closely?

A: Shame on you for making a purchase offer to buy a property you really didn't want to buy. A better approach would have been to obtain a purchase option.

Now, if you don't complete the purchase, the seller might sue you for damages, since his property was tied up for six months and he might have lost another profitable opportunity to sell the property.

Depreciation Must Be Taken on Property

Q: I had substantial losses in 1989 in my business, so I do not need any tax loss from the depreciation of several rental houses I own. How should I show on my 1989 income tax returns that I am not deducting any depreciation for 1989?

A: Sorry, but after you acquire depreciable real estate held for use in a trade or business you must keep depreciating it. Although the depreciation won't save you any income taxes, you must still reduce the basis of your depreciable property every year.

However, you can carry over unused tax losses from your investment properties. Many investors have built up substantial losses, which can either be used in future tax years or you can use them to offset realty sales profits. Please consult your tax adviser for full details.

Fixer-Uppers in City Offer Profit Potential

Q: I believe real estate offers the best long-term investment in growing cities. But I am receiving conflicting advice as to whether to invest in older property, such as a rental house, or a brand-new building that probably won't need much repairs. What do you advise?

A: Although you will usually have fewer headaches with new buildings, there often isn't much profit potential in such property. I recommend older structures which can be profitably upgraded to increase their market value by more than the cost of the improvements.

Depreciation Allowed on Straight-Line Basis

Q: Years ago I used to invest in apartment buildings, but I sold them. Now I am thinking of buying investment property again. I recall something about Congress changing the rules on depreciation. Please clarify the choices as to how many years I can use for depreciation?

A: You don't have any choice. Current law says you must depreciate residential rental property over at least 27.5 years and commercial property over at least 31.5 years. Only straight-line depreciation is available. No more accelerated depreciation. Please consult your tax adviser for more details.

Get Tax Advice Before Abandoning Property

Q: I am a partner in a group that owns an apartment building in Texas. It is now worth less than the mortgage balance. Some of the partners think we should stop making mortgage payments and let the lender foreclose, since we have virtually no chance of selling it for what we owe. It is losing money and we can't afford the property taxes. Do you think we should abandon the building?

A: Before you decide, please consult your tax adviser. In the situation you describe where you will be receiving mortgage relief, if your depreciated book value for the property is below the mortgage balance, the IRS says you will owe profit tax on the difference.

Lease-Option Buyer Gains Tax Advantage

Q: I am acquiring an apartment building on a 30-year lease with an option to purchase. The reason for not acquiring the title is to avoid having the mortgage lender enforce the due on sale clause on the 7.5% interest rate mortgage.

I will make my payment to the seller who will then pay the mortgage lender. However, the seller says he is entitled to keep the depreciation deduction, since he will still hold the legal title. But my CPA says I should get the depreciation writeoff, since I am the "equitable owner" even though I am not yet the "legal owner." Who is right?

A: Your CPA is correct. For income tax purposes, the IRS recognizes a lease of 30 years or longer, coupled with an option to purchase, as the equivalent of a sale. Since the IRS recognizes this as a sale, you are entitled to the depreciation tax deduction.

This is much like a land contract or contract for deed where the seller retains the title, but the buyer is the equitable owner entitled to all the income tax ownership benefits.

Incidentally, the way lenders learn about a title transfer is from the new fire insurance policy. You may wish to keep the old fire insurance policy in the seller's name, but with you added as an additional loss payee.

Evidentiary Exhibit Number 212

Chicago Tribune

June 10, 1990, Sunday, FINAL EDITION

SECTION: REAL ESTATE; Pg. 2J; ZONE: C; Realty Q&A

LENGTH: 757 words

HEADLINE: Mastering five basics in financing real estate

BYLINE: By Robert Bruss

BODY:

Q - I am a novice real estate salesman, just getting my feet wet. But I am confused about all the possible ways to finance home sales. Is there any simplified way of explaining the home finance alternatives?

A - The five basic ways to finance property sales are (1) all cash (very undesirable because of the tax laws, leverage disadvantages and inflation), (2) a seller who finances the sale, such as by carrying back a first or second mortgage or trust deed, or sells on a land contract, (3) a buyer's assuming an existing mortgage already on the property or purchasing "subject to" the existing mortgage, (4) the buyer's obtaining a new conventional, FHA or VA mortgage from a lender and (5) any combination of these methods.

You never can learn too much about real estate financing. Although seller financing is the easiest and best money source, you need to know about the other alternatives because not every seller will help finance his or her sale.

I strongly recommend your taking a real estate finance course at your local community college and reading good books on realty finance, such as Peter G. Miller's "The Common-Sense Mortgage" (Harper and Row, 1990), available in stock or by special order at local bookstores.

Q - A few months ago my wife and I bought a six-unit apartment building. Our first vacancy will be coming up next month. We are discussing whether to offer the new tenant a one-year lease or if we should go month-to-month. Which is better for us?

A - Many tenants prefer one-year leases because the rent cannot be raised during the term of the lease. Most landlords believe that a one-year lease protects them from a tenant's moving out during the year. But experienced landlords know that a tenant who wants to move is going to move whether or not there is a lease in effect.

Personally, I don't care if the tenant wants a one-year lease or a month-to-month rental. I let the tenant decide. Most select the one-year lease, but after the lease expires, then my lease terms provide that it automatically converts into a month-to-month rental agreement. Please consult a real estate attorney for further details.

Q - For the last three years my husband and I have managed a small apartment building where we get a free apartment. At first our goal was to save toward a home down payment what we would have paid for rent. We have saved almost $30,000. But we enjoy managing the apartment building, get along great with the landlord and tenants and would hate to move. Do you think we should move anyway?

A - No. However, it would be a very smart investment to buy a house and rent it to tenants. Someday you will decide to move out of that desirable rental situation. Then you will have a home into which you can move. Meanwhile you can enjoy the tax benefits and probably rising market value.

Although most people do not want to do it, the smartest thing you can do is rent the residence in which you live and own a rental property to which you might like to move someday if the rental comes to an end.

Q - Since I started reading your columns I have become very interested in real estate, both as a possible sales career and for investing. But I am uncertain I want to quit my engineering job as I have an excellent income with outstanding benefits. I have read your book "The Smart Investor's Guide to Real Estate," but I want to know more about the realty basics. Where would be the best place to learn more before deciding if I should make a career change?

A - In most cities local community colleges and universities offer excellent low-cost real estate classes. Start with the real estate principles course and then take more advanced classes on real estate finance, appraisal and law.

You soon will know if you really want to become a realty salesperson or if you prefer just investing in real estate. Frankly, you probably will earn much more investing in property than earning sales commissions.

But I must add a word of caution. If you think you want to become a real estate salesperson because you think that will give you an advantage finding property bargains, you will be disappointed. Most realty sales agents do not earn enough to invest in property.

Please note: Real estate laws differ from place to place, and laws of your area should be checked before making decisions on real estate problems. Robert Bruss will answer inquiries addressed to Tribune Real Estate Features Service, P.O. Box 280038, San Francisco, Calif. 94128.